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# The Political Economy of UK-China Economic Relations 1997-2015

by

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requirements for the degree of Doctor of  
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## **Declaration**

I hereby declare that the work contained in this thesis is my own, and that it has not been submitted for examination for a degree at another university.

## **Abstract**

This thesis seeks to explain the evolution of UK-China economic relations in the period 1997-2015. The UK and China are two of the most powerful countries in the world, with large economies, sizeable military expenditures and considerable voice in international institutions. China has seen substantial economic growth throughout the period, overtaking the UK in terms of total GDP in the late 2000s. Perceptions of China have also changed, as the 1990s optimism of the 'unipolar moment' changed by the 2010s to a greater recognition of the potential challenge China poses to the liberal global order. This thesis aims to fill the gap in UK-China literature by exploring how bilateral economic relations have changed as China has grown and played a more active global role during the period.

To do this, a four-level game model based upon Putnam's (1988) two-level game is built to make sense of the relevant domestic, national and supranational actors and to identify the changes that have occurred. There are five games on four levels: the UK domestic politics, the Chinese domestic politics, the EU, international institutions and then the bilateral relationship. Changes have occurred in each of these games, but Chinese economic growth is the most important factor.

The thesis is structured around four main topics: human rights, trade, investment and finance. Each of these topics is analysed empirically using archival work, elite interviews and quantitative analysis. The thesis argues that UK-China relations have been predominantly an economic relationship with human rights having been reduced in significance as China became more powerful. The primary source of this power was investment, as the UK economy became sensitive to Chinese government decision making. However, whilst there has undoubtedly been a power shift, this shift has been exaggerated by perceptions of China as a rising superpower.

## **List of Abbreviations**

AIIB	Asian Infrastructure Investment Bank
BBC	British Broadcasting Corporation
BCBS	Basel Committee on Banking Supervision
BCEG	Beijing Construction Engineering Group
BIT	Bilateral investment treaty
BP	BP plc (formerly The British Petroleum Company plc)
CBBC	China–Britain Business Council
CBRC	China Banking Regulatory Commission
CCP	Chinese Communist Party
CCTV	China Central Television
CIC	China Investment Corporation
CIRC	China Insurance Regulatory Commission
CITIC	CITIC Group Corporation Ltd (formerly the China International Trust Investment Corporation)
CNPC	China National Petroleum Corporation
CPI	Consumer Price Index
CSP	Corporate social responsibility
CSRC	China Securities Regulatory Commission
ECJ	European Court of Justice
EFD	Economic and Financial Dialogue
EU	European Union
FCA	Financial Conduct Authority
FCO	Foreign and Commonwealth Office
FDI	Foreign Direct Investment
FSA	Financial Services Authority
FSB	Financial Stability Board
FSF	Financial Stability Forum
FTA	Free trade agreement
FTSE	Financial Times Stock Exchange
G7	Group of Seven
G20	Group of Twenty
GATT	General Agreement on Tariffs and Trade
GCHQ	Government Communications Headquarters
GDP	Gross domestic product
HRW	Human Rights Watch
HSBC	HSBC Bank plc (originally founded as The Hongkong and Shanghai Bank)
IAIS	International Association of Insurance Supervisors
ICBC	Industrial and Commercial Bank of China
ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights
IFI	International financial institution
IJV	International Joint Venture
ILO	International Labour Organization
IMF	International Monetary Fund
IO	International organisation
IOSCO	International Organisation of Securities Commissions

IPE	International political economy
LSEG	London Stock Exchange Group
MEA	Multilateral Environmental Agreements
MNC	Multinational Corporation
MOFCOM	Ministry of Commerce
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PBOC	People's Bank of China
PhD	Doctor of Philosophy (from Latin philosophiae doctor)
PRA	Prudential Regulation Authority
RMB	Renminbi
RPI	Retail price index
SAFE	State Administration of Foreign Exchange
SDRs	Special drawing rights
SSBs	Standard Setting Bodies
SSE	Shanghai Stock Exchange
UK	United Kingdom
UKTI	UK Trade & Investment
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNHRC	United Nations Human Rights Council
UPR	Universal Periodic Review
US	United States
WFOE	Wholly Foreign-Owned Enterprise
WTO	World Trade Organization

# **Chapter 1: Introduction**

## **1.1 Introduction**

The UK and China are two of the most economically powerful countries in the world. In terms of nominal GDP, China is the world's second largest economy; the UK is the fifth largest (IMF 2016). Both countries are among the world's largest traders: China is the world's largest exporter and the second largest importer; the UK is the fifth largest importer, the ninth largest exporter overall and the second largest exporter in commercial services (WTO 2015). London, Shanghai and Hong Kong are global financial centres, each with important stock exchanges that have a combined market capitalisation of over US\$13 trillion (World Federation of Exchanges 2015). Both the UK and China have powerful voices inside global governance institutions, including a permanent seat on the UN Security Council.

The economic flows between these two countries have evolved substantially in recent years. During the 2000s, there was a vast increase in the volume of goods that the UK imported from China – leading to familiarity with the phrase 'made in China'. The UK government has tried to gain market access in China for UK exporters, expanding publicly-funded agencies that support British businesses and pushing the Chinese government into removing trade and investment barriers for British firms. There was a substantial increase in Chinese foreign direct investment (FDI) into the UK after the global financial crisis and now many household brands are all or part-owned by Chinese companies. Financially, Chinese banks have an increasing presence in the City of London and London has growing powers to settle and trade the renminbi currency. Politically, the lingering question of human rights threatened to intervene in what was otherwise a primarily economic relationship.

This project sheds light on this economic relationship. It asks the question: "How can we explain the evolution of UK-China economic relations 1997-2015?" The evolution of economic relations – including trade, investment and finance – and the political issue of human rights will be discussed, and the main drivers identified and explained. To do this the project will make use of a four-level game model, based on

Robert Putnam's (1988) two-level game. The model helpfully splits up the UK-China economic relationship into five games, so that the relationship becomes easier to explain. It is not always obvious how domestic politics, bilateral relations and supranational governance fits together; this model makes it easier. In the four-level game model, the five games – UK domestic, Chinese domestic, bilateral relationship, EU and global governance – fit together neatly and allow us to locate and identify the drivers of change and evolution of the relationship.

The model helps to assess the importance of the different games. The thesis will argue that the most important factor for explaining the changing relationship is the economic growth of China, which gave rise to a larger middle class that could buy UK products and services as well as greater overall outward investment. For the UK, the increased economic reliance on China led to a power shift, best explained using Keohane and Nye's (2012) complex interdependence model. The UK and China were both dependent on each other, but the UK became more dependent on China as time went on, meaning that China had more bargaining power and thus was able to get more of what it wanted.

The Chinese domestic game is the most important for all four topics in this thesis, though the importance of the other games varies depending on topic. The UK game is important because of the changing construction of China, which exaggerates China's actual material power. This is most obvious on human rights, as the UK government went silent on human rights out of a fear that China would punish the UK economically. To explain this well, the thesis will add a thin constructivist element to the broader liberal framework.

The 'higher' levels of global governance and the EU are significant as well, though not as significant as the China game and only on some issues. China's 2001 entry into the WTO was a significant moment for the world economy, as will be argued in chapter five, because of the trade liberalisation that it caused and the associated increase in China's trade flows, including with the UK. This affects the issue of trade, and to a lesser extent investment as well, but has little bearing on human rights or finance. Similarly, the EU is a very significant actor regarding trade because it has competence over trade policy. However, the EU has little competence over finance

so has almost no influence on that topic, and limited influence over human rights and investment. In this way, every game has at least some bearing on the evolution of UK-China relations, although to differing degrees and in different ways.

The rest of this introduction is structured as follows. The next section sets out the geopolitical context of UK-China relations, arguing that the UK and China have faced opposite geopolitical trajectories: the UK has had a century of relative decline; China has experienced forty years of spectacular economic growth. There has also been a significant change in East-West relations between the 1990s and 2010s, which strongly impacts UK-China relations. The introduction then reviews the existing literature on UK-China relations, arguing that the literature is underdeveloped. There have been a few articles and books on specific aspects of the UK-China relationship, such as the Hong Kong handover, but the only substantial work on long-term relations are the largely autobiographical books by Kerry Brown (2015; 2016; 2019). This leaves a gap in the literature, which this project aims to fill.

The introduction then discusses the aims of the project. The main substantial, original contribution to knowledge that this thesis makes is the empirical work on UK-China relations. The overarching research question is “how can we explain the evolution of UK-China economic relations 1997-2015?” A single thesis cannot exhaust discussion on such a large topic, so the topic has to be narrowed by limiting the time period to the 1997-2015 period and focusing on economic issues, rather than security issues. The next section outlines the methodology, with a mixed methods approach advocated (Creswell and Plano Clarke 2011). Three methods are used in this thesis: archival research, elite interviews and descriptive statistics. The introduction ends with a brief outline of the structure of the thesis.

## **1.2 Geopolitical Context: Old versus New Empires?**

One of the most obvious differences between the UK and China is their differing geopolitical trajectories. Britain was the world’s foremost military and economic power during its ‘Imperial Century’ between 1815 and 1914 (Hyam 2002). Since then, the US has become, and remains, the world’s leading power and Japan, China



and other European countries have caught up with or exceeded the UK in terms of total GDP (IMF 2016). In the 1990s, Andrew Gamble (1994: xiii) argued that “Britain has now been in decline for a hundred years” and that managing and coming to terms with this relative economic decline was a major theme of British policymaking in the twentieth century. The UK remains a great power in international affairs because of its GDP, military strength, cultural ties with the Commonwealth and representation in international institutions. However, the overall geopolitical trajectory is one of relative decline.

China is in a very different geopolitical position. China endured a ‘Century of Humiliation’ between 1839 and 1949, during which European empires and Japan defeated China in multiple wars, took reparations, opened up China for trade and forced China to cede territory (Kaufman 2010). The role of the Opium Wars and Britain’s colonisation of Hong Kong in this will be explained in chapter three. However, as a result of Deng Xiaoping’s 1978 economic reforms, China’s economy has grown phenomenally. China’s GDP increased twenty-five fold between 1978 and 2013 (Lardy 2014: 1). China now has the world’s second largest economy and is commonly perceived as an emerging superpower.

These opposing geopolitical trajectories seem to cross over during the period this thesis studies, at least by GDP and military spending – two popular and quantifiable, albeit flawed, proxies for power. In 1997, the UK had a higher GDP than China, and had higher defence spending, as the graphs below show. Past trends cannot automatically be extrapolated to the future, however it would take a significant disruption to China’s economic growth or national strategy for China to fall below the UK in the foreseeable future. Figure 1 below shows the GDP of China and the UK in the period 1990-2016. As will be explained in the methodology section later in this chapter, there are various problems with measuring economic statistics, particularly on the Chinese side.

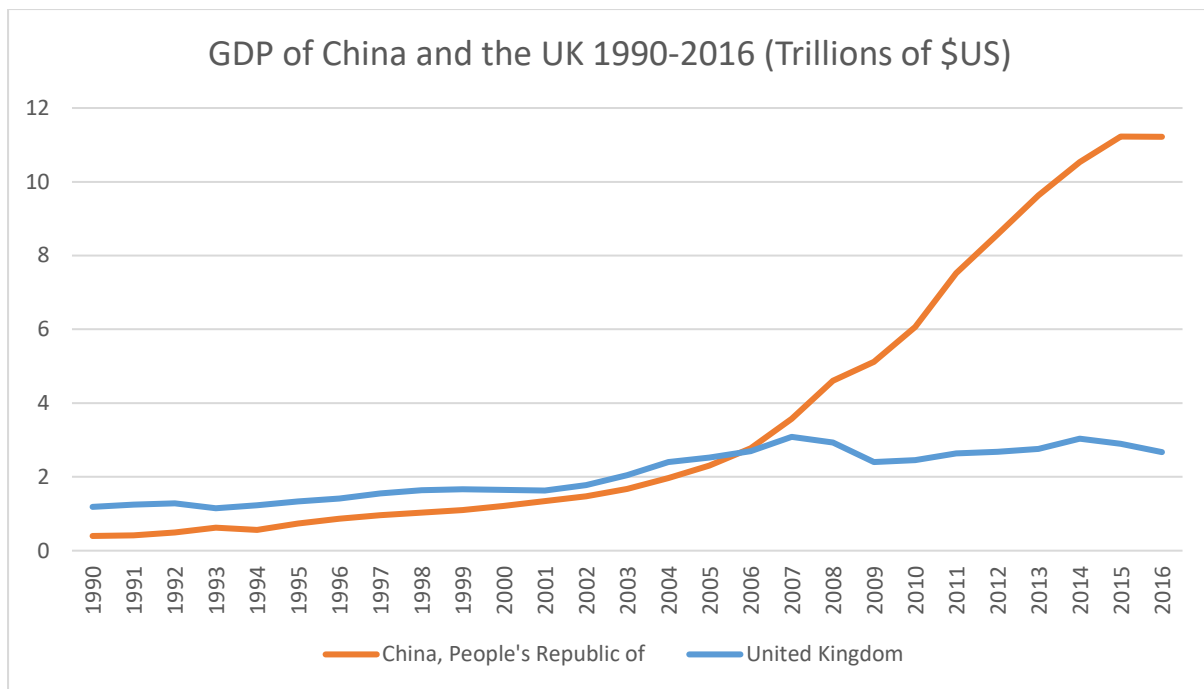


Figure 1 - GDP of China and the UK 1990-2016 in trillion of \$US in 2019 prices (IMF 2016)

This graph clarifies that China's GDP has changed much more substantially than the UK's has over the last thirty years, both in absolute and proportional terms. It also shows that 2006 was a crossover year, when China's GDP became higher than the UK's. By 2016, China's GDP was over four times the UK's in aggregate terms, though China still lags far behind in per capita terms. Data over defence spending – another popular proxy for power – tells a similar story. Figure 2 below shows military expenditure of the UK and China in the period 1990-2017 in billions of US dollars adjusted to current prices (SIPRI). The general shape of the graph is similar to the GDP graph in that the UK leads China in the 1990s and early 2000s, China overtakes in the latter half of the 2000s, and then China continues to grow exponentially and far exceed the UK by the late 2010s.

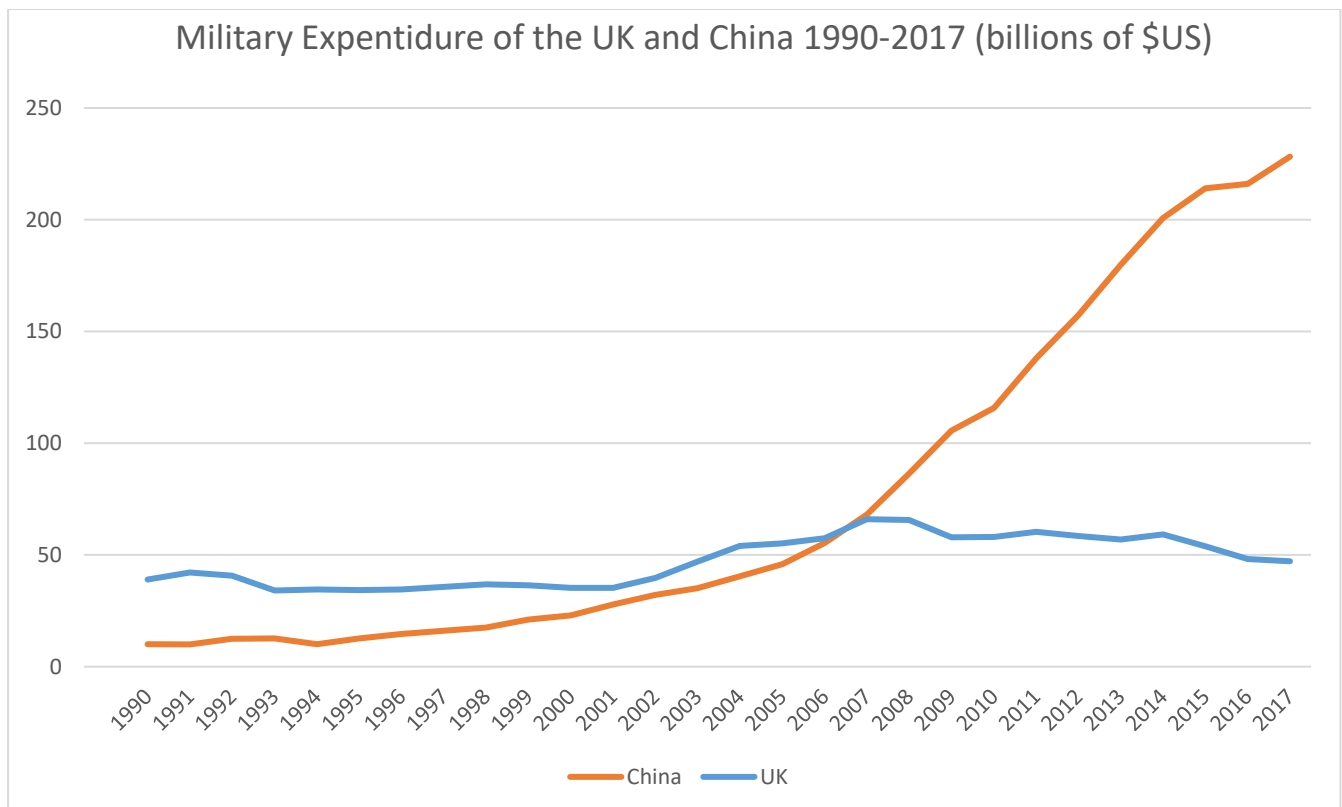


Figure 2 - Military Expenditure of China and the UK 1990-2017 in billions of \$US in 2019 prices (SIPRI)

The geopolitical context of UK-China relations is inherently intertwined with the overall geopolitics of East-West relations. The two proxies of GDP and military expenditure suggest a power shift from the UK towards China, but there is also a more general global shift from the West to the East. Most importantly, this includes the role of the US which, whilst not directly related to UK-China relations, inevitably plays a role. This is partly because the US is the world's most powerful country and thus shapes the international system, but also because the US is the leader of 'the West'. Many of the issues in UK-China relations are also broader issues in relations between China and the West so it is useful to provide an overview.

The power shift from the West towards the East is a combination of material and ideational factors. The material factors are predominantly economic and includes China's increased market power and greater worldwide investment portfolio, which gives China some leverage on political disputes, including human rights. The power change implied by these material factors is exaggerated by the change in perceptions of China by policymakers and academics. As China has grown, it has

been perceived as a greater threat to Western values and interests. This can be shown by comparing the mood of the 1990s to the mood of the 2010s.

The 1990s was in many ways a period of optimism for the West. The US had won the Cold War over the Soviet Union, leaving it unchallenged as the world's sole superpower – the 'unipolar moment' (Krauthammer 1990). Ideologically, America's victory in the Cold War led many to the conclusion that capitalism and democracy were simply superior forms of government to all alternatives. Francis Fukuyama (1993) even went as far as to argue that mankind had reached the 'end of history' and the end of its ideological development. In this view, it was only a matter of time therefore before all countries adopted liberal, capitalist democracy. With regard to Western relations with China, the confidence in Western power and values meant that China was not perceived as a threat but rather would liberalise both politically and economically. For example, during the negotiations over China's WTO accession in the 1990s, Bill Clinton (2000) argued that his WTO policy was "likely to have a profound impact on human rights and political liberty" in China. This was a time of great confidence in the superiority of liberalism and of Western types of governance.

Fast forward to the 2010s however and this rosiness had largely disappeared. The West had been undermined, not least by the economic crisis, and populism was on the rise in both Europe and the US. The much-promised Chinese democratisation had not happened (at least not yet) and President Xi had shown himself to be the most powerful and authoritarian Chinese leader for decades, arguably since Mao Zedong (Osnos 2015). China's activities in the South China Sea, Central Asia, Africa and Latin America sought to expand Chinese influence, often at the expense of Western influence and to the detriment of political liberalisation (eg Kaplan 2015; Davies 2016; Myers and Wise 2016). International Institutions that could previously have been relied on to promote liberal values (and indeed Western interests) were either undermined by China or replaced by institutions more favourable to Chinese values and interests.

This change in perception has influenced attitudes towards China itself and policy towards China in the West. Friedburg (2018: 7) argues "there appears to be a

growing consensus ... that prevailing policies towards China have failed and that an alternative approach is now urgently required". This alternative approach, Friedburg argued, related to constraining China and putting more emphasis on the security challenges posed by China. Other Western commentators have increasingly constructed China as a threat to Western interests. GCHQ boss Jeremy Fleming said that Chinese technology companies were a security threat to the UK (*Times* 2019, 25<sup>th</sup> February). French President Emmanuel Macron has advocated greater restrictions on Chinese investment in Europe, warning against naivety in international trade (Reuters 2017). In the US, Senator Marco Rubio (2018) said he was "not sure" if the US had in its history "ever faced a competitor and potential adversary of [the] scale, scope, and capacity" of China.

This geopolitical shift is a theme that runs throughout this thesis. The greater assertiveness of China has coincided with a loss of confidence by the West in not only itself but also Western values, which makes the West more willing to compromise on issues such as human rights. At the same time however, economic flows have grown substantially and this has increased the interdependence that exists between the East and the West. These themes provide the global context under which UK-China relations occur.

### **1.3 UK-China Relations**

It is rather surprising that such little literature exists on UK-China relations, particularly when compared to the vast amount of literature on US-China and EU-China relations. Since the People's Republic of China was established in 1949, only a handful of articles or books have been written about UK-China relations and these have been mainly in response to specific events, such as the Korean War or the Hong Kong handover. UK control over Hong Kong, and the subsequent question of the reversion to Chinese sovereignty, created a political context that dominated the bilateral relationship. This means that broader political economy trends, for example around trade and finance, have been ignored in academic writing in favour of security or territorial issues. The lack of political economy-focused literature may not have been an issue in the mid-twentieth century, when China had a much smaller

economy and economic flows between the UK and China were less significant. However, more recently economic flows have become much more significant, which warrants research.

After the Chinese Civil War, the first main piece of academic work on UK-China relations was a book by Robert Boardman (1976) about British attitudes and policies towards China. Several of the questions that Boardman looks at are similar to the issues addressed in this project, such as assessing whether British policy towards China was merely “the cynical pursuit of material self-interest” (Boardman 1976: ix). This book is largely descriptive, based on secondary sources that were available at the time it was written – which is considerably less information than is available today. During the period that Boardman writes about, relations between Britain and China had been heavily influenced by the United States and the Soviet Union in the Cold War, which differs from the 1997-2015 period covered in this thesis.

Other literature exists on UK-China relations during the Cold War, although it tends to be on more specific topics. Wolf (1983), Tang (1992) and Ovendale (1983) all deal with the British reaction to the Chinese Communist victory in the Chinese Civil War and the formal British recognition of the People’s Republic of China in 1950. MacDonald (1990) discusses Britain’s role in the Korean War, where Britain and China were on opposing sides. Hoare (1994) looks at the politics behind the location of the British Embassy in Beijing 1949-1992 – an embassy he worked in – and the possible reasons why the embassy is so cramped and overcrowded. Finally, Victor Kaufman (2001) contrasts the British and American approaches to China in the period 1948-1972, and shows how the Anglo-American alliance survived despite serious disagreements. These papers are interesting, but seem very historical given how much the world and China have changed since.

After the end of the Cold War in the early 1990s, literature was written about the run-up to the 1997 Hong Kong handover. Peter Ferdinand (2000) wrote a chapter on UK-China relations up to 1997, in which the significance of Hong Kong on relations was emphasised. Ferdinand (2000: 29) argued that, until 1997, British relations with China were always “coloured” by Hong Kong and, as the 1997 handover date approached, the bigger the issue became. In addition to Ferdinand, several former

senior diplomats and officials wrote books about the period which, although should be considered autobiographical rather than academic, are useful. Robin McLaren (1997) dealt with Britain's relations with Hong Kong leading up to 1997. Percy Cradock (1994) discussed his experiences of China as ambassador and a leading British negotiator before the declaration on Hong Kong. Chris Patten (1998) explained his experiences as the last Hong Kong governor. This literature is helpful for understanding the background on Hong Kong, which until 1997 was the most important issue between the UK and China. However, since 1997 the relationship has moved on and Hong Kong does not have the significance that it once did.

Since 1997, there are five pieces of literature that have been written. Firstly, Shaun Breslin (2004) wrote a paper on UK-China relations 1997-2004, in which he discusses the two objectives of the UK government policy towards China as being to create commercial opportunities and to promote social change in China. Although liberal theory might suggest that economic liberalisation would achieve both objectives, Breslin argues that the increased power of non-state economic actors means that private interests, which prioritise profit and not human rights, become more important. Breslin uses the increasing role of private (or quasi-private) agencies, such as the Chinese British Business Council (CBBC), as evidence of the increased importance of private interests.

Kayte Rath (2006) looks at New Labour's attitudes towards the EU's arms embargo on China, where it publicly supported the policy of lifting the ban. Rath argues that human rights considerations were manipulated by the UK government to serve its economic interests, and that the only reason why the embargo was not lifted was because of outside pressure, particularly from the United States. Rath's article provides a case study of how the political and ethical issue of human rights does occasionally raise its head and have some impact on the nature of the economic relationship, despite it being less significant than economic gain.

Most recently, Kerry Brown has published three pieces of literature on UK-China relations. The first is Kerry Brown's (2015) analysis on diplomacy, entitled *What's Wrong with Diplomacy?* The book is partially autobiographical, since Kerry Brown once worked as a British diplomat, and his arguments are based upon his

experiences – making it different to the ‘ivory tower’ perspective of a lot of UK-based academic literature. Brown uses the UK’s diplomacy towards China as a case study to argue that diplomacy is too elitist, lacking imagination and failing to adapt to technological change. He makes proposals for how to improve diplomacy, though it is questionable how practical Brown’s suggestions are. He argues that British policy towards China should develop a greater overarching vision, yet also argues it should be decentralised and popularised, failing to address the apparent contradictions between these two proposals (Cotton 2016). Nevertheless, this book makes a contribution to the literature and is useful as a source for this project.

The second, entitled *Erase and Unwind* (Brown 2016), is in report-style and looks at how UK-China relations is a product of its history. Brown (2016: 6) starts by arguing that “Britain and China have a long and complex relationship”, particularly regarding Hong Kong. Both the UK and China wanted to move on and had mutual economic interests in doing so for economic reasons. The two countries also want to change the perception of themselves in the other country: the UK wants to be perceived as being innovative, modern and creative; China want to be perceived as a cultural equal to the UK. These economic and cultural issues have the potential to create a new framework for future relations.

Third is Kerry Brown’s (2019) most recent book on UK-China relations is entitled *The Future of UK-China Relations*. As its title suggests, this aims to be a forward-looking book, analysing the possible directions that relations could take over the coming decade. A whole chapter is devoted to Brexit, with much speculation on what might happen. The book also discusses the ways in which the UK and China are perceived by the other and the how they wish to be perceived. This book is again useful, but is rather speculative given it focuses on a future relationship that has not yet happened. It is also an anecdotal book, based upon Brown’s own experiences.

In addition to the political literature, a body of literature from other fields of study also exists. Li and Hewitt look at UK-China trade relations from an environmental perspective, arguing that carbon emissions have been shifted from the UK to China (Li and Hewitt 2008). Some literature has also been written on relations from a business studies perspective. Andrew Millington, Markus Eberhardt and Barry



Wilkinson have written about UK companies in China and the problems of corruption (Millington et al 2005). Peter Buckley has written about investment in China from a business perspective (eg Buckley et al 2007a; Buckley et al 2007b; Buckley et al 2006). Of particular interest to UK-China economic relations is the paper *Opportunities for UK Businesses in China's Regional Cities*, which was written on behalf of the China-Britain Business Council (CBBC) and UK Trade & Investment (UKTI) (China-British Business Council and UK Trade and Investment 2008). The political framing for this paper is to promote opportunities for British private companies operating in China; human rights are not mentioned at all. This may not be surprising given the intended audience is firms, though it does reveal the nature of British diplomacy in China, of using public money to assist private businesses.

#### **1.4 The Aims of this Project**

The brief literature review shows that the existing literature is out of date and largely fails to provide a discussion of the political economy issues. Most of the literature was written before the late 2000s 'crossover' when the UK was still ahead on GDP and military expenditure. The only scholar to have written about UK-China relations recently is Kerry Brown, whose work suffers from at least two limitations. The first is that his work is informed largely through his own experiences as a diplomat, which can make his arguments very anecdotal. There is minimal engagement with international relations theory, existing academic literature or archival data. The second limitation is that Brown's work focuses on the diplomatic issues, rather than the political economy issues that arise from the relationship.

This project seeks to advance the literature on UK-China relations by explaining the economic flows between the UK and China in the years 1997-2015. The overarching research question is "How can we explain the evolution of UK-China economic relations 1997-2015?" These flows have increased substantially, but have not been adequately investigated. To answer this question, a multi-level game model will be set-up in the next chapter that combines liberalism and constructivism. Four empirical topics will be studied: human rights, trade, investment and finance. These four topics make up chapters four to seven of this thesis.

By its nature, a PhD thesis can only cover a limited area of study and therefore it is necessary to limit the scope of the topic. This is done in two ways. Firstly, the project is focused on the issues of human rights, trade and investment and less on security issues. Security issues are addressed when they are relevant to economic issues, particularly in investment, but are not the primary focus. This is also reflected in the theoretical basis, which is IPE focused.

Secondly, the thesis is limited in scope by the time period, which is 1997-2015. The nature of history means that it is quite difficult to be schematic, particularly in peacetime. It is nonetheless necessary for practical reasons to have a defined time period. The starting point of 1997 is easier to justify because of the long-awaited Hong Kong handover, which ended 150 years of British control. As will be argued in chapter three, 1997 represented a sharp change in the tone of UK-China relations because in the twenty years leading up to 1997, Hong Kong was the primary focus – indeed, so dominant that other issues simply often were ignored or subsumed within the Hong Kong issue. Starting the research topic in 1997 focuses the research in a clear-cut way.

The end date that has been chosen is 2015, as this was also the peak of the ‘golden age’ in relations. In October 2015, President Xi made a state visit to the UK during which £50 billion of trade and investment deals were reportedly signed. This avoids the issue of Brexit, and was also the peak in the ‘golden age’ of relations. In practical terms, an eighteen-year period is a good size for a PhD project, and cutting off the period in 2015 meant that data is available for the whole period.

Things happened after 2015 that are still in a state of flux and re-ordering and will continue to be so for some time to come. This is partly as a result of leadership changes within the ruling Conservative Party on the UK side, partly as a result of the uncertainties surrounding Brexit, and also partly as a result of the potentially even greater uncertainties of the long-term consequences of the COVID-19 pandemic. At time of writing, there is considerable uncertainty over how these issues will play out either by themselves or with regard to UK-China relations. For this reason, the thesis

period ends at 2015. In the conclusion, there will be a postscript that discusses how some of the recent issues have moved on in the period 2015-2020.

Finally, one of the other features of this project is that asymmetric attention will be paid to the UK side of the bilateral relationship. The emphasis is on UK policy towards China, and this means that China is only considered insofar as it motivated China's behaviour and influences a response from the UK. There are also several practical reasons for this asymmetry, including the ease in accessing information on the UK side relative to the Chinese side and the lack of language barriers. This is explained further in the methodology section below.

### **1.5 Project Contribution**

The project makes a number of original contributions to knowledge. The most substantial original contribution to knowledge is the empirical work, which is absent from academic literature. The existing literature fails to engage with the available empirical data for economic relations, which is necessary for having a full understanding of the topic. As the methodology section below sets out, the thesis uses archival analysis from human rights dialogue and economic and financial dialogue meetings, descriptive statistics and elite interviews to further understanding of UK-China relations.

Given the significance of both the UK and China to the international system, and the size of economic flows between them, UK-China economic relations is a significant area of study in its own right, similar (albeit to differing extents and regarding different issues) to Germany-Russia relations or US-Japan relations. Within the field of international relations, interactions between major powers are always worth studying. Of course, the key point is that there is a gap in the literature on UK-China relations, whereas other bilateral relations between major powers have been written about extensively. But aside from being an interest topic in its own right, there are four other reasons why UK-China economic relations 1997-2015 is an interesting and significant topic that is worthy of academic research.

### **1.5.1 The Rise of China**

As well as being of interest to UK political economy, this thesis is also of interest to the literature on Chinese international political economy. The rise of China is one of the most important issues in the whole of social science, and within that is China's international relations. Great power politics is one of the main lines of enquiry in IR, therefore the question of how China is interacting with and challenging the international system is inherently interesting (Brown 2017: 2). Recently, a lot has been written about China's "new assertiveness" (Johnston 2013) and how its behaviour has changed as the economy has grown.

Most of the literature on China's rise focuses on the impact on the global order (eg Mearsheimer 2006; Ferdinand and Wang 2013; Breslin 2013), on relations with the US (which is often intertwined with the global order) (eg Friedburg 2018; Ferguson and Xu 2018) and China's regional backyard (eg Christensen 1999; Swannstrom 2005; Fazilov and Chen 2013). When it is extended to Europe, the focus has overwhelmingly been on the EU level rather than looking at nation states (eg Meunier 2012; Mattlin 2012; Scott 2014 – a notable exception is Fox and Godement 2009). And there are considerable differences in the nature of individual European relations with China and responses to China's rise. It is not just UK-China relations that are understudied, but the policy and China's relationship with a whole range of individual European states as well, such as Germany-China relations and Sweden-China relations. Therefore, there is a need to bring the national level back in when it comes to European relations with China. The emphasis is on European here, rather than the EU, which (as is demonstrated throughout the thesis) is part of the equation, but only one part of it.

This thesis makes some contribution to this topic by analysing China's behaviour with regard to the UK. This fills in part of the gap of overall Europe-China relations, but also acts as a case study to test ideas in the literature on China's overall international relations. The result of testing with case studies should be to understand how China's international relations varies by country, which provides for a more nuanced and advanced understanding of how China interacts in the

international sphere. It is also interesting how countries behave towards China, and the UK also provides a case study in this regard.

### ***1.5.2 The Broader Question of UK Decline***

One of the questions that this introduction has discussed so far is the question of UK decline. In relative terms, the UK is in military and economic decline since other economies and militaries are growing at a faster rate than the UK. Decline has become a major theme of post-war British political economy. Gamble (1994: 1) says that British decline “has become the most observed and analysed decline in modern history”. There is a large literature on recent British decline that come from different perspectives and cover different aspects of political economy (eg Rubinstein 1993; Gamble 1994; Crafts 2012; Tomlinson 2016). This literature generally focuses on domestic factors, such as de-industrialisation and competition, rather than international factors. Where international factors are discussed, it is usually in relation to the US or Germany, the industrial powers that were the first to overtake Britain.

This thesis updates this literature by re-framing British decline in relation to East Asia. It is empirically true that UK relative decline has continued, since UK growth rates are lower than global growth rates (IMF 2016). In global terms, East Asia has a greater effect on British decline than Europe or the US, quite simply because East Asia’s growth rates are much higher. Yet, the literature on British decline has not yet taken this into account; indeed, UK-Asia relations as a whole is a very underexplored area of research. By exploring UK-China economic relations and analysing how relations have evolved, this thesis adds a new dimension to the picture of British decline which complements and expands the existing literature. How UK policy towards China has evolved is intertwined with British decline, and feeds into modern debates about ‘Britain’s place in the world’. This thesis speaks to these broader debates and thus makes a useful contribution.

### ***1.5.3 Policy Implications of Work***

Finally, this thesis has implications for UK policy towards China. As will be argued in chapter two, there are relatively few people directly involved in the making of UK policy towards China. The majority of the input into UK-China relations – aside from the short-lived public interest during major visits – come from a narrow group of interested individuals. The analysis provides a useful recent history that could guide policymaker decisions by discussing the trends and narratives that successive governments have faced. This is particularly important given the commonly assumed likelihood that China will become a more important part of the UK's foreign policy thinking in the coming decades; a likelihood that increased as government ministers reflected on Chinese action during the early days of the COVID-19 pandemic. Policy towards China is already a significant issue, but could become an even more significant issue in the future.

## **1.6 Methodology**

This project uses a theoretical lens that is liberal mixed with thin constructivism, and it is important that the methodological approach and methods of data collection fit with this. This is problematic because positivism and constructivism are different worldviews which make different philosophical assumptions and imply different methodological approaches (Creswell and Plano Clark 2011: 40-43). To overcome this, a pragmatic worldview will be adopted which overcomes the dichotomy. John W. Creswell and Vicki Plano Clark (2011: 41) view a pragmatic worldview as focusing on “the primary importance of the question asked rather than the methods” and having a practical, pluralistic research orientation. It values both objective and subjective knowledge, and uses whatever is most appropriate for the research problem being addressed.

This pragmatic worldview lends itself to a mixed methods approach. Johnson et al (2007) say that “mixed methods research is an intellectual and practical synthesis based on quantitative and qualitative research” and argue that this approach will often provide “the most informative, complete, balanced, and useful research results”. The methodological approach is effective because it recognises the

contribution of the “two cultures” of quantitative and qualitative methods (Mahoney and Goetz 2006), and makes use of their complementary strengths (Greene et al 1989). Using different research methods also allows for triangulation, which Denzin (1970: 297) defines as “the combination of methodologies in the study of the same phenomenon”. Triangulation allows the data generated to be validated and, since different data sources provide different types of information, gives a “more complete, holistic, and contextual portrayal” of the topic studied (Jick 1979: 603). Three data collection methods will be used in this project: descriptive statistics, archival analysis and elite interviews.

### ***1.6.1 Descriptive Statistics***

The first data gathering method is the descriptive statistics of quantitative data that shows the economic flows between the UK and China. Burnham et al (2004: 138) say that “the main appeal of descriptive statistics is that they offer a powerful and economical way of measuring, analysing and presenting political phenomena”. For the chapters on trade, investment and finance, descriptive statistics play an important role in understanding the story of what is occurring. Clearly, the level of and change in trade, investment and financial flows between the UK and China is vital for analysing UK-China economic relations.

Economic data has been retrieved from a range of sources. Macroeconomic data is usually easy to access from a range of sources including the Bank of England, the Treasury, the Office for National Statistics, National Bureau of Statistics of China, the IMF, the World Bank and the City of London. Some microeconomic data, such as trade data on specific industries, is also used throughout the thesis, usually accessed from industry bodies. For example, tourism statistics provided by VisitBritain are used in the trade chapter. This combination of macroeconomic and microeconomic data gives a picture of UK-China economic flows using one type of data.

There are various methodological problems with quantitative data. Diane Coyle’s (2014) study of GDP shows that statistics have considerable definitional and

measurement problems that are often highly political. Broom and Quirk (2015) argue that quantitative statistics are never totally value free and often have “hidden normative agendas”. For example, the UK government has on several occasions arbitrarily changed inflation measures between RPI and CPI because they were different and the government wanted to either save money or enlarge price increases (eg Peston 2011; *Independent* 2018, 19<sup>th</sup> August).

Chinese data has even more problems, being frequently criticised for being politicised and unreliable. As the country with the world’s largest population, it can be difficult to compile economic data simply because of the size and complexity of the economy (Shapiro 2018). However, in addition to this, the centralised nature of the economy makes the data even less reliable because of the potential for officials, both at state and province level, to manipulate figures to meet targets or other political objectives (Holz 2014). In 2017, the governor of Liaoning province admitted that the province had falsified its financial data between 2011 and 2014 to exaggerate its economic performance (*China Daily* 2017). It is unsurprising that, as Holz (2014: 4) says, “Chinese official statistics have a bad name”.

In addition to the definitional and measurement problems, there are other methodological problems inherent in using international data. One of these is problems of currency conversion. If GDP from countries with different currencies is to be compared, then the values need to be converted into the same currency. This is particularly difficult with China because of the uncertainty over which exchange rate to use. For many years, China was accused of undervaluing its currency (eg Krugman 2010b) meaning that a nominal conversion to US dollars (such as the GDP graph earlier in this chapter) would understate China’s actual GDP. There is no obvious way of overcoming this, particularly as there is disagreement on what the market-forces exchange rate would have been (Breslin 2005: 9).

Trade and Investment data is also subject to measurement problems, because it can be difficult to keep track of these flows. A major reason for this is that sometimes trade and investment flows do not travel directly between China and the UK, but via a third country such as Hong Kong. Between 1979 and 2004, Hong Kong accounted for 43% of China’s cumulative inward FDI (Sung 2006), despite being a relatively



small economy. It is difficult to know exactly how much this changes the data, but it is reasonable to assume that some of this had been re-invested from a third country (Chiang 2016). Trade between the UK and China that goes via Hong Kong is also not included in the bilateral statistics, which could plausibly understate them. The Rotterdam Effect, where the Netherlands distorts EU trade data, is also relevant (HM Revenue and Customs 2005). Economic data remains incredibly useful, but is not without limitations.

### ***1.6.2 Documentary and Archival Research***

The second method of data collection is documentary and archival research, which involves collecting, sorting and analysing historical documents. Burnham et al (2004: 190) say “all forms of bureaucracy, whether public or private, national or global, produce documentation”. Some of this documentation is available and useful for research into politics and other disciplines, especially history. A distinction is made between primary, secondary and tertiary sources: primary sources “consist of evidence that was part of the event in question” and were not normally released to the public; secondary sources were publicly available and produced at or shortly after the time in question; tertiary sources consist of “material written afterwards to reconstruct the event”. (Burnham et al 2004: 187).

The documents used by this project are generally secondary sources, including memoirs, parliamentary debates and reports, speeches, press conferences, press releases, government reports, manifestos, newspaper articles and reports from NGOs. Documents that could be argued to be primary sources include the minutes of Economic and Financial Dialogue meetings and Human Rights Dialogue meetings since they are internal documents of government departments, although like secondary sources they are often made publicly available online soon afterwards. It would have been better to use more primary sources, but they were not available. Gathering the available documents was relatively straightforward since the majority could be accessed online.

The information collected from these documents has several uses for this project, which are consistent with the theoretical perspective. As Burnham et al (2004: 194) argue, these documents “form the essential outer framework for political research and of course are often the result of the policymaking process”. The most obvious use is to find out factual information, such as the dates of visits and meetings, the topics discussed and the agreements reached. This information is useful for building a picture of the diplomatic events and exploring which issues are particularly relevant in different periods. This goes a long way to explaining the evolution of relations during the period studied.

Documents can also be useful for discovering actor’s assumptions and stated preferences. When an actor advocates a particular policy action or a government minister explains his or her reasons for a decision, it is useful information when seeking to uncover an actor’s motivations. Burnham et al (2004: 191) argue that documents “may help us guard against overtly structuralist and deterministic forms of explanation”. They reveal the thought processes and personalities of the people involved in key decision making, which cannot be revealed from policy documents alone. This can show how policy is socially constructed by the actors involved, which fits with the thin constructivist part of the theoretical perspective. For example, it will be shown that UK politicians frequently construct China as being an emerging superpower, which in turn affects preferences towards it. Again, this contributes to the overall picture of how relations have evolved.

There are however limitations of documentary sources that are important to consider. First, is that documents released after the event, such as memoirs, may be concerned with personal reputation rather than an objective recording of events. This means events could be reinterpreted in the light of more recent events, or simply a more favourable slant than could be reasonably justified (Burnham et al 2004: 192). Secondly, documents released to the public are not always reflective of an organisation’s actual preferences. On human rights for example, politicians may say they are important but then not meaningfully follow through on that in practice. To determine whether an actor’s stated preference is different to their actual preference, it is necessary to understand the overall context: “the researcher [should] pay particular attention to the conditions under which the document was produced and

the material interests that may have driven the author to write the document” (Burnham et al 2004: 210).

However, the biggest limitation of documentary sources is that they often do not tell the whole story (Burnham et al 2004: 194). Debates recorded in Hansard for example, provide a large amount of information, but backbench MPs are not always close to the policy-making process. Similarly, publicly-released documents by government departments show the result of the policy-making process rather than the making of it, so only tell part of the story. Newspaper articles are a useful source of information but cannot always be relied upon. The solution to these problems is to use a range of methods to get a more holistic view of a topic.

### ***1.6.3 Elite Interviews***

The third type of data collection is elite interviews. This is the most challenging and time-consuming method, since – unlike the other two, which can be carried out using the internet – elite interviews have to be arranged and travelled to, and there are greater practical and ethical considerations because a researcher deals with real people (Dexter 1970; Moyser and Wagstaffe 1987; Rubin and Rubin 1995; Burnham et al 2004). Leech (2002: 663) says: “elite interviewing can be used whenever it is appropriate to treat a respondent as an expert about the topic in hand”. This applies to this project because many people are inherently involved with UK-China relations and can therefore be considered an expert in a certain aspect of the relationship.

There are different approaches in the literature to what type of data should be gathered at elite interviews. The positivist approach advocated by King, Keohane and Verba (1994: 111-112) argues that, while there is a place for abstractions, social science research should be “as concrete and precise as possible”; interviewers should ask for facts, rather than motivations. On the other hand, a constructivist approach to elite interviewing puts the emphasis on motivations and perspectives. For example, Manning (1997: 105) advocates “dialogical conversations” in which the interviewee’s perspective on a topic is “discovered and created”. The types of questions implied by these approaches differs significantly because the positivist

approach implies closed questions while the constructivist approach implies broad, open questions.

The interview data gathered for this project used semi-structured interviews to gather both types of information. This satisfies both paradigms, since both factual questions and questions about perceptions were asked. Factual questions aim to uncover objective information – for instance, asking which issues have been raised in particular meetings. In addition, questions about perceptions will help with the thin constructivist element of the project. To do this, the project uses semi-structured interviews, which occur when the interviewer has a limited number of questions prepared and intends to ask follow-up questions (Rubin and Rubin 1995: 31). The information gathered from the interviews fits with the theoretical perspective, which is liberal with thin constructivism.

The main problem with elite interviews was gaining access to the relevant people. Many people contacted either did not respond, or were too busy to be interviewed. This meant that less data was gathered from interviews than had been hoped for, which presented problems. The small sample size of interviewees makes it difficult to be confident they represented the views of people in their industry. Politicians, bankers and human rights activists are not homogenous so an interview with one person cannot tell you about the range of opinions within a particular profession, only the view of the person interviewed. There is also the problem of interviewees wanting to exaggerate their own role in events and reinterpreting historic events in the light of more recent events, which undermines the reliability of the information gathered. The representation problem is exacerbated by the interviewees all being either British or American, due to language barriers and access problems on the Chinese side. This makes the interview data unbalanced, which is taken into account when analysing the data.

Nonetheless, there was still some data gathered in the five interviews that were conducted with two former government ministers, one MEP, the China director of Human Rights Watch, and a senior London investor. The main benefit from the interview data was to support information gathered by other means. As Burnham et al (2004: 246) argue, “quotations from the elite interviews can do a great deal to

enliven a publication". Elite interview quotations are not the basis for the research, but rather enriches the data gathered using the other two methods.

#### ***1.6.4 Combining the Methodologies***

This thesis uses a convergent mixed methods design, meaning that data from the three methods are collected simultaneously in a single-phase approach (See Creswell and Creswell 2018: 217-221). The convergence of the three different data gathering methods ensure the project is methodologically pluralistic and that a mixed methods research design can be used. This allows for triangulation of different sources, and makes use of the complementarity of quantitative and qualitative data. The overarching research question – to explain the evolution of UK-China economic relations 1997-2015 – can be answered more comprehensively using three different methods. The methods have also been carefully designed to be compatible with a liberal and thin constructivist theoretical approach. In this way, the research question, theoretical perspective, research design and research methods fit together comfortably.

#### **1.7 Structure of the Thesis**

In order to answer the overarching research question, the rest of the thesis is structured in the following way. Chapter two sets up the study by explaining the theoretical perspective. It will begin by arguing that liberal IPE is effective at explaining the modern global economy, including China's rise within it. The chapter then explores the attractiveness of a thin constructivist element, particularly with regard to the way China is perceived by other countries. It will be argued that the thin constructivist element is compatible with liberalism. Using this theoretical grounding, a four-level game model is then built using Putnam's (1988) framework. Five games – the UK game, the China game, the EU game, the international organisations game and the bilateral game – are set up and introduced. This chapter contains the outline of all the theoretical tools used in the thesis.

Chapter three gives an outline of UK-China relations 1997-2015, identifying the key turning points. It argues that the 1997-2015 period can be split-up into five stages. The first is the Hong Kong handover, which concluded decades of discussions and, for China, removed an obstacle to happy relations with the UK. The second stage was a focus on trade in the decade between 1997 and 2007, during which China joined the WTO and increased its trade with the rest of the world substantially. The third stage was the response to the global economic crisis after 2008, when both countries attempted to stimulate their economies. The fourth stage was the freeze, which occurred when China cut off diplomatic relations after David Cameron met with the Dalai Lama in 2012. The fifth and final stage was the UK competing for Chinese investment and finance, which led to Xi's big 2015 visit. The purpose of this chapter is to provide a timeline so that a clear ordering of events can be established, which is useful in the analysis in chapters four to seven.

Chapter four is the first empirical chapter and looks at human rights and democracy. UK and China have very different ideological histories and systems of government, which have evolved over many centuries. This chapter argues that human rights have been the largest source of non-economic tension between the two countries. For the UK, human rights promotion is a stated goal of its foreign policy, and several campaign groups and MPs push human rights. China, on the other hand, dislike foreign countries commenting on or criticising its domestic policies, including on human rights. The EU's values are embedded in human rights and the EU has its own human rights dialogue with China. However the EU's approach suffers from being incoherent and weak. International organisations are best placed to challenge China on human rights, but are far from effective. The bilateral game includes a human rights dialogue, but there is nothing to suggest that it has achieved anything significant.

Chapter five turns to trade. Trade between the UK and China has grown substantially in the 1997-2015 period in both directions. The chapter argues that the main cause of the changes in UK-China trade relations was the growth in China's economy. In 1997, China was the industrial powerhouse of the world and so the trading relationship was predominantly about cheap, Chinese goods being exported to the UK. As China's economy grew and its middle class expanded, China became

a greater importer of goods, typically high-end, and the low-skill manufacturing moved to other countries. The UK has an interest in both exporting to China and receiving low-cost imports, although there were clear losers as well from the decline in manufacturing. The issue of losers from trade with China affected countries across the EU, which made having a coherent EU trade policy towards China challenging when some countries favoured protectionism and some favoured free trade. On the international level, trade was helped significantly by China's accession into the WTO in 2001, which lowered trade barriers and helped to better integrate China into the global economy.

Chapter six covers investment. The flows of investment have increased substantially since the financial crisis, although the stock remains relatively low. Investment was the main source of China's power over the UK since the financial crisis, as the UK was desperate for inward FDI at a time when China was dramatically increasing its outward FDI. This gave China more negotiating power, which it used to seek to punish the UK diplomatically during 'the freeze' in response to David Cameron's meeting with the Dalai Lama. Investment is also a contentious issue in Europe, with countries competing to attract Chinese investment, leading to fears of a 'race to the bottom' on security and human rights issues.

Chapter seven concerns finance. The City of London is well placed to partner with China on financial issues because of the needs of both parties. China's growing power in the international economy, and desire to continue growing, necessitates improvements to its domestic financial system and access to global financial markets. The City of London is one of the world's most advanced financial centres and can only benefit from managing more capital. China and the City of London have sought to work together on renminbi trading in London and on a London-Shanghai stock connect, although both are in early stages.

Chapter eight offers concluding thoughts. The overarching thesis question of how we can explain the evolution of UK-China economic relations is answered directly. The main factors are the changing economic position of China in the global economy, the long-run effects of the economic crisis and the particular interest in China taken by George Osborne. Material and ideational factors are important in the changing

relationship: material factors because of the increase in the size of China's market and of China's outward investment; ideational because of the change in China's perception by other countries. Chapter eight ends with a reflection on future directions in UK-China relations, particularly in the context of Brexit and China's increasingly apparent domestic problems.

Finally, after the conclusion there is a postscript to cover UK-China relations 2015-2020. This has been included to account for the developments since the thesis end point. There are four topics discussed in this chapter. The first is the most obvious: Brexit. UK-China relations is likely to change because of the possibility of a new UK-China trade deal after the UK has left the EU single market and customs union. Secondly, the situation in Hong Kong has moved on, with continued protest and tension around perceived Chinese interference. Thirdly, the impact of the recent US-China trade war featuring President Trump. Then finally, China's failure to achieve market economy status in the WTO. The thesis concludes by comparing the 1997-2015 period with the 2015-2020 period in relations.



# **Chapter 2: Theoretical Perspective**

## **2.1 Introduction**

All research is grounded in theory and therefore it is essential to set-out the theoretical perspective in order to identify assumptions made. This thesis uses a theoretical approach that is liberal but that makes use of a thin constructivist element. Liberalism does an excellent job of explaining the global economy in the twenty-first century. Keohane and Nye's (2012) idea of 'complex interdependence' captures how the fortunes of economies are inherently tied together so that nations have a strong interest in cooperating. Liberal IPE also explains the importance of market power, which is very relevant to a Chinese economy that trebled in size in the period. The thin constructivist element is a helpful addition because of China's "imagined power" (Breslin 2015: 236), caused by the perception of China as an emerging superpower. This combination of liberal IPE and thin constructivism is used in a four-level game, based upon Putnam's (1988) two-level game.

## **2.2 Liberal IPE**

Cohn (2012: 77) argues that "liberalism is the most influential perspective in IPE". The influence and popularity of liberal IPE comes from its effectiveness in understanding the global economy and globalisation, as well as its long history. Although IPE as a discipline only goes back to the 1970s (Cohen 2008: 17), liberal IPE has foundations that go back earlier, drawing on the work of classic liberal thinkers such as Locke (1689;1690), Smith (1776) and Mill (1948). Although political economy was split into political science and economics, IPE brought the two fields back together ending what Susan Strange (1970) called "mutual neglect". Paul (2010) says that liberal IPE "is the offspring of a marriage between mainstream international economics with its focus on markets and mainstream international relations with its emphasis on the state." The interdisciplinary nature of liberal IPE is a major strength.

Liberal IPE emphasises individual agency, which is vital for understanding the global political economy. Individuals have their own interests and are generally act in what they believe to be their own interests (that does not mean that conceptions of self-interest cannot be influenced, as the next section will explain). Individuals cooperate when it is mutually beneficial, and compete over political power when they have conflicting interests. Institutions are important as a commitment mechanism and to reduce transaction costs, enabling greater cooperation both domestically and internationally. As individuals and countries have greater interconnectedness than ever before, liberal IPE become more relevant and even better able to explain the modern world.

The concept of “complex interdependence” captures these modern realities of the global political economy well. Keohane and Nye (2012: 20-21) say that there are three main characteristics to complex interdependence. The first is that there are multiple channels connecting societies, including informal ties between elites, financial organisations and MNCs. Secondly, multiple issues are discussed in an interstate relationship that are not in a hierarchy. This sits in contrast to realism, which always puts security issues at the top. Thirdly, military force is not used “when complex independence prevails” (Keohane and Nye 2012: 21). This third point is essentially commercial peace theory, which states that free trade makes peace more likely because it increases the costs of war.

The nature of power has changed in the modern era of complex interdependence. In general terms, “A has power over B to the extent that he can get B to do something that B would otherwise not do” (Dahl 1957: 202-203). In the past, a country’s power was determined by its military strength, however that no longer holds in a world where economies are more closely connected and wars are less likely (Keohane and Nye 2012: 9). To understand power in this context, Keohane and Nye (2012: 10) introduce the concepts sensitivity and vulnerability. Sensitivity “involves degrees of responsiveness within a policy framework”. If a decision is made in one country, how significant are the effects upon another country? Vulnerability “rests on the relative availability and costliness of the alternatives that various actors face” (Keohane and Nye 2012: 11). In other words, sensitivity is the cost an actor faces without any policy changes; vulnerability is the scope an actor has to change policy and reduce the

costs to itself of a policy change elsewhere. Power comes from other actors being sensitive and vulnerable to decisions you make, thus providing greater ability to negotiate.

This model of complex interdependence captures the modern realities of globalisation very well, and is applicable to UK-China relations. Keohane and Nye's (2012: 3) starting assertion that "we live in an era of interdependence" is the defining characteristic of the post-war era. China's rise over the last forty years has involved becoming more interdependent with the global political economy. This can be shown by the vast growth in trade, investment and financial flows both in and out of China (Echeverri-Gent et al 2015), and China's greater engagement with international organisations (IOs) particularly the WTO. Ferguson and Schularick (2009) term the symbiotic relationship between China and the US in the 2000s 'Chimerica', although they also argue it broke down after the financial crisis due to its unsustainability. China's interdependence was with the entire world, although the US played an important role as the world's biggest economy.

Within this complex interdependence, China has gained in power as its economic model has changed. In the 1990s and early 2000s, when exports were the centre of China's growth model, China's power in the global political economy was weak because the Western MNCs could have moved their factories to a whole range of countries across the global south to benefit from cheap labour. China was vulnerable to decisions made in the West; China had to accept the MNCs, or else they would simply have moved to a different country. After the economic crisis, China's economic model moved towards outward investment, for which the vulnerability was reversed. Rather than China competing with other countries for Western manufacturing jobs, the UK now competed with other countries for Chinese investment. If the UK was not willing to accept Chinese conditions, which includes political conditions, then China could simply take its investments elsewhere. This is similar to what happened during the freeze, when diplomatic relations were cut off after David Cameron's meeting with the Dalai Lama. It was only when the UK gave into China's political demands that investment picked up again, cumulating in President Xi's 2015 visit.

However, this power shift affected different domestic actors differently, and liberalism also does well at connecting international affairs to domestic politics. As Helen Milner (1997: 3) argues, “domestic politics and international relations are inextricably interrelated” (see also Hanrieder 1971; Carlsnaes’ 1986; Putnam 1988). This means that international relations affects domestic actors, and this can be both positive and negative. Thomas Friedman (2005) takes a positive view of globalisation, demonstrating how the world is flattening because of technology and global supply chains, creating a more level playing field for businesses in developing countries. The increase in global trade flows – in 2014, a quarter of global production was exported (Ortiz-Ospina et al 2014) – improves consumer choice. Globalisation has also been associated with poverty reduction, as the proportion of people living on below \$1.90 a day (in PPP terms in 2011 prices) fell from 36% in 1990 to 10% in 2015 (World Bank).

That is not to say that globalisation was good for everyone. Liberal IPE emphasises that there have been winners and losers from globalisation and that states have not managed to redistribute the gains to avoid some communities being worse off. Stiglitz (2002: 214) discusses the “discontents” from globalisation, arguing that globalisation has been poorly managed and “is not working for many of the world’s poor”. Dani Rodrik (2011) described globalisation as a “paradox” and argued for a more tempered model. More recently, Rodrik (2017) has argued that the redistributive effects of economic globalisation have been a major cause of the rise in populism. China has played a major role in Western discontent from globalisation, and many of the manufacturing jobs lost in the West have gone to China. Scott and Mokhiber (2018) find that 3.4 million American jobs were lost to China in the period 2001-2017 due to the trade deficit, three-quarters of which were in manufacturing. The lens of liberal IPE illuminates the winners and losers within countries from globalisation.

Liberal IPE also helps to explain why international organisations are important. Keohane (1984) argues that international institutions facilitate greater levels of mutually-beneficial cooperation between self-interested actors. Keohane and Martin (1994: 43) emphasise “the role of institutions in providing information” that makes cooperation more likely. Thomas Christiansen (2016: 31) provides two reasons for

the increase in importance of international organisations. Firstly, IOs have “independent actorness”, which necessitates considering their agency and potential to influence outcomes. Secondly, IOs set global rules that constrain states behaviour. Global economic governance is therefore a game in itself, and occupies the top of the four-level game, explained below.

The overall result of liberal IPE is to create a highly effective model of the global political economy. It accounts for political, economic and social factors. It puts together domestic, national and supranational actors in a way that respects their agency. It explains how different types of institutions produce different political and economic outcomes. It provides a convincing explanation of globalisation and the winners and losers from it on the national and domestic level. Liberal IPE therefore forms the predominant theoretical basis for this thesis and how UK-China relations have evolved in the period 1997-2015.

### **2.3 Thin Constructivism**

Liberal IPE is an effective grounding for explaining globalisation and the increase in international economic flows. However one aspect that it is less effective in is explaining the role of ideas. Ideas matter in the global political economy and in politics more generally. Finnemore and Sikkink (1998: 889) argue that “norms and normative issues have been central to the study of politics for at least two millennia”, and that studying norm dynamics can provide useful insights into the way politics works. This section introduced the constructivist approach to IPE, argues that adding an element of thin constructivism improves liberal IPE, then explains how thin constructivism is relevant to China.

The constructivist school of international relations emerged around the end of the Cold War in response to the ‘neo-neo’ debate between neo-liberalism and neorealism (Finnemore and Sikkink 1998: 890). Nicholas Onuf’s (1989: 1) book *World of Our Making* was one of the founding texts in constructivism and argued that “people always construct, or constitute, social reality, even as their being, which can only be social, is constructed for them”. Alexander Wendt (1992) advanced

constructivism with his dictum “anarchy is what states make of it”. Wendt makes anarchy the subject of research, and then draws from sociology to argue that power politics is socially constructed. This opposes the realist view that says that power politics is the natural, logical outcome of international anarchy. What is most important, according to Wendt, is how states are perceived by other states and how a state socially constructs its own interests and identity.

Constructivism had been applied to the economic sphere in several ways. John Ruggie (1982) argues that the norm of “embedded liberalism” has been adopted by international organisations, which shapes how they behave. Ngaire Woods (2006) argues that the IMF and World Bank have acted as “the globalizers”, trying to push liberal economic norms upon the world. At least two sub-fields of new institutionalism have used ideas to explain institutional change. Historical institutionalists, such as Peter Hall (1991), use ideas to explain how institutions have evolved throughout history, paying close attention to path dependence. Discursive institutionalism (also known as constructivist institutionalism), used by Mark Blyth (2002) and Vivian Schmidt (2008; 2010), “is concerned with both the substantive content of ideas and the interactive processes of discourse in institutional context” (Schmidt 2010: 1). The discursive institutionalist approach in particular emphasises the dynamic role of ideas and is less concerned with material interests, certainly compared with rationalist approaches explained above.

This theoretical basis for this thesis mixes an element of thin constructivism to liberalism. Thin constructivism recognises the importance of both material factors and ideas. David Marsh (2009: 679) argues “the relationship between the material and the ideational is...dialectical, that is interactive and iterative”. Marsh welcomes the growing focus on ideas in political academic literature, but warns against the “concomitant rejection” of materialist factors. Full, “thick” constructivism pays insufficient attention to material factors and ignores that ideas and perception can often come from material reality. Ideas do matter though, and a theoretical position that is predominantly liberal but which adds thin constructivism achieves a healthy balance between the material and the ideational.

The thin constructivist element improves liberalism in two ways. Firstly, it reveals more about how preferences are formed. Liberal economists tend to assume a set of preferences and then analyse them. Paul Samuelson (cited in Sen 1977: 325) once argued that the only technical requirement for an agent being rational was that they had a coherent set of preferences. These preferences may be revealed by behaviour, but the concept of rationality says nothing about how preferences are formed or what makes people desire certain things. Mark Blyth (2002: xii) says: “Ideas matter because they can actually alter people's conception of their own self-interest”. Material factors shape preferences as well, but do not account for them entirely. Liberalism and constructivism fit together nicely therefore in that constructivism helps understand how preferences are formed, while liberalism explains how actors cooperate given their preferences. This way of incorporating ideas into a rationalist institutional framework has also been used by Goldstein and Keohane (1993).

The second feature of constructivism that adds to the liberal perspective is around uncertainty. Rationalist models can only do so much at predicting the future because the future is inherently unknowable. Frank Knight (1921: 19-20) argued that the difference between risk and uncertainty is that risk is measurable whereas uncertainty is not. This ‘Knightian uncertainty’ cannot be measured and causes problems for businesses. More recently, Nassim Nicholas Taleb’s (2007) theory of black swan events argues that highly improbable events play a disproportionate role in shaping history, and thus social scientists need to pay more attention to outliers. (The reference to black swans is because they were presumed not to exist because no European had seen one, until they were observed in Australia in the late seventeenth century.) This demonstrates a limitation of inductive reasoning, which is used by positivists including proponents of liberal IPE.

This limitation of inductive reasoning is particularly appropriate to the rise of China and China’s future growth prospects. It is no exaggeration to say that the vast economic growth seen in China over the last forty years is unseen throughout human history (Lardy 2014). Furthermore, China is culturally very different to the Western major powers, and the only other non-Western major power, Japan, lacks the population or military strength of present-day China. Economic and/or political

models that are based on observations of Western countries cannot straightforwardly be applied to China. It is no surprise that there is so much disagreement among scholars over China's future growth prospects, with some confident that China's rise will continue for many decades to come (eg Cox 2007; Ikenberry 2008; Subramanian 2011; Glaser 2011; Rachman 2011) and others arguing that China's political economic model is on the verge of collapse (Chang 2001; Gorrie 2013; Shambaugh 2015).

This future uncertainty, and the way that this affects the present, creates a space for thin constructivism to make a useful contribution. Blyth (2002: 32) argues that ideas are necessary for actors to make sense of uncertainty, otherwise it would be "cognitively impossible" for actors to make decisions. Similarly, Leonard Seabrooke (2007: 373) argues:

"This form of uncertainty forces us to build constructs for the management of information that seem not only reasonable to ourselves but to others. It also permits ideas to be used as weapons in a struggle over what institutions should be constructed to mitigate uncertainty"

In this way, ideas about the future influence the present, which in turn then shapes the future. This is a great example of the dialectical relationship between the material and the ideational as theorised by Marsh (2009).

The uncertainty over China's future growth – and indeed the uncertainty over China's future position as a superpower – means that people need to construct ideas about China. For British political leaders, the constructed idea is that China's rise is inevitable. In his autobiography, Tony Blair (2010: 677) said: [China's] economic and political power, already vast, is only a fraction of what it will be". Gordon Brown (2005) said there was "the potential for Asia to be the 21st century's equivalent of America's rise in the 20th century". David Cameron said that "the rise of China is one of the defining events of our century" (*Guardian* 2014, 17<sup>th</sup> June). In an article, George Osborne and Jim O'Neil (2015) explicitly described China as "the world's next superpower".



Like UK leaders, the international community has constructed China as an emerging superpower and so give China greater respect that its current material capabilities would justify (Babones 2011; Beckley 2011; Eichengreen 2011; Wolf 2011). Shaun Breslin (2015: 236-237) argues that this gives China “imagined power”: “the way that other states have built their policies not on what China is at any given time, but on what they expect it to become”. Given the norm that China will continue to grow economically and militarily, China’s power in world politics is exaggerated. As is common with a rapidly growing power, it is also possible that China is overconfident of its own power and exaggerates the decline of the West (Nye 2010: 150-151).

These thin constructivist contributions are vital throughout the thesis. As time has gone on, and particularly after the financial crisis, perceptions of Chinese power vis-à-vis British power have increased on both the UK and Chinese side. This shift in imagined power magnifies the shift in material power, through factors such as market size and the ability to invest internationally. On human rights (chapter four), this shift creates a reluctance on the part of the UK to challenge China on its human rights record. The biggest impact of constructivism is in investment and finance (chapters six and seven). Norms of future Chinese growth motivate the UK government to seek inward investment and financial links that are difficult to explain just using current material factors.

## **2.4 The Chinese View of IR Theory**

So far, this chapter has focused exclusively on Western theories and ideas about IR and IPE. Almost all the academics that have so far been cited are either British or American, and come from an elite group of academic institutions – indeed many of the main theorists this thesis references work, or have worked, in the same building at Harvard Kennedy School. For the most part, this should not be a problem for developing theories of international relations because an objective researcher should be detached from what he is studying (King et al 1994). Empirical observations are such that it should not make a difference who the observer is to the phenomenon observed. An understanding of the Chinese perspective on international relations is

useful however for understanding the Chinese perspective, which influences the Chinese government's preferences.

The development of IR in China has been framed by three debates, which concern the challenges that China have faced since opening up (Qin 2011). The first was about the nature of the international political environment, particularly whether it was characterised by war or peace. The second was how to define and realise China's national interest. The third was whether China could rise peacefully. All of these debates have been covered in Western IR, but the focus is different with far more attention paid to China.

Similarly, Chinese IR theories are fundamentally the same theories as Western IR theories, but with Chinese characteristics. American IR has been brought into Chinese universities and now features in Chinese language debates (Noesselt 2016). Realism is the most popular theory in China (Qin 2008), and is certainly recognisable when compared with the theories of American realist scholars such as John J Mearsheimer or Stephen Walt. Attempts have been made to bring in Chinese ideas in Western IR theory. For example, Qin Yaqing (2009) brought in the Chinese ideas about process and relations into realism, liberalism and constructivism.

Despite the emergence of Chinese language literature on IR, there is not yet a proper Chinese school of IR. Qin (2005) argues that a school needs "a clear and significant core problematic". The American school is centred on a hegemonic maintenance and the English school is centred on international society, but Chinese IR does not yet have a core problematic. In addition, the Chinese school of IR is not coherent and indeed sometimes is used interchangeably with the study of IR in China (Wang and Buzan 2014: 9). For the purpose of building a theoretical model, the Chinese school of IR adds very little to the existing Western theories of IR.

However, in this thesis the Chinese perspective on issues is of course useful and relevant in explaining and evaluating how UK-China economic relations have evolved. In the four empirical chapters in the thesis, all discuss the Chinese perspective. However, it is only the human rights chapter that goes into philosophical discussion. The other three empirical chapters concern economic issues so the

Chinese perspective can be reduced to Chinese interests. This goes some way to avoid the accusation of Western-centrism.

## **2.5 The Four-Level Game**

Within the theoretical framework that is liberal with an element of thin constructivism, this project makes use of Robert Putnam's (1988) two level game. This is a liberal, game theoretical model designed to disentangle domestic and international politics. Game theory "aims to help us understand situations in which decision makers interact" (Osborne 2004: 1) and is widely used in the social sciences including in international relations (Powell 1994). Actors interacting with each other is inherent to politics and a natural part of a bilateral relationship between two countries. Domestically, the public, NGOs, businesses and politicians interact with each other as part of the formulation of government policy.

The two-level game model works by having three games on two levels: there is the international level, where the leaders of each country negotiate, and the domestic level for each country. Each national leader is playing at two different games; they have to negotiate with the other national leader, but also have to satisfy their own country in the domestic game. There is no set domestic theory of politics: the two-level game can be married to a wide variety of theoretical perspectives, from Marxism to interest group pluralism (Putnam 1988: 442). A feature of having three interconnected games being played simultaneously is that the political complexities are staggering, since national leaders and major domestic players can upset the entire game at any time.

The two-level game model is particularly useful for analysing the constraints that each government or international actor faces. Putnam (1988) powerfully demonstrates that domestic constraints influence a bilateral negotiation, something neorealism fails to take account of. A national government is constrained by a 'win-set', which is 'the set of all possible [international] agreements that would "win" - that is, gain the necessary majority among the constituents - when simply voted up or down' (Putnam 1988: 437). Ultimately, all international agreements have to be

acceptable to each domestic sphere, so for an agreement to be possible, the win-sets have to overlap. The point of agreement would fall somewhere in the intersection. Win-sets therefore can help to explain change in bilateral relations, since if a relationship changes it is either because the domestic constituencies have changed, affecting the win-set, or the leadership of either country changed and took a different view, changing the point within the win-set.

The size of a domestic win-set changes international negotiations in several ways. Firstly, a larger win-set makes an agreement more likely *ceteris paribus*, because there is greater chance of a win-set intersection existing (Putnam 1988: 437). Secondly, a larger win-set reduces a government's negotiating power because they can be "pushed around" by the other negotiators (Putnam 1988: 440). A classic tactic that negotiators will try to employ is to try to reduce their own win-set to drive a harder bargain. Domestic institutions also affect the size of the win-set, with democratic countries generally having smaller win-sets because their political institutions have more veto points. This theorises how domestic politics affects international negotiations.

### **2.5.1 Modifications to the Two-Level Game**

Putnam's model has been applied to a number of relationships, including between two states (Schmidt 1996; LeoGrand 1998; Feliu 2003; Shamir and Shikaki 2005; Chung 2007; Knopf 2009), treaties between three or more states (Balzacq 2006), between the EU and another state or actor (Patterson 1997; Meunier 2000; Larsen 2007; Hwang and Kim 2014), within the EU (Pahre 1997; Pelkmans et al 2000; Guild 2007), between a state and either an international organisation or international agreement (Lehman and McCoy 1992; Rapkin et al 1993; Lisowski 2002), and to international trade agreements within international organisations (Paarlberg 1997; Ostry 2004). Some of these papers have introduced a third level of analysis to better tailor the model to the issue studied. For example, Sophie Meunier (2000) looks at EU-US trade negotiation and asserts that there are three levels that interact: domestic, supranational (European) and international. Similar three-level games are set-up in other papers (Zartman 1993; Collinson 1999; Pollack 2003). Four level

games have also been attempted, usually to account for sub-national decision makers (eg Thibert 2015: 225; Eskelinen et al 2019: 54).

In addition to modifying the structure of the game, some scholars have relaxed the game theoretical assumptions that underpin Putnam's model. Howard P. Lehman (1993) removed the assumption of rationality and introduced a learning process to strategic interaction in the model. Such a relaxation can account for mistakes that leaders make, as well as an evolution of thought towards changing foreign policy issues. It also accounts for the role of information in international relations, which can be an important factor (Evans 1993; Mowlana 1997; Milner 1997). Lehman's modification effectively introduces a constructivist element since ideas and perceptions become relevant for government negotiations.

This project modifies Putnam's model in two main ways, both of which are similar to what has previously been done in the literature. Firstly, the strict rationality assumption is removed for the reasons relating to uncertainty explained in the previous section. A thin constructivist element is introduced to take into account the importance of the ways in which China and the UK are perceived by each other and in the global political economy. This particularly helps theorise the imagined power that China has had since the financial crisis, which exaggerates China's material power.

The second modification to Putnam's model is that the two-level game changes to a four-level game. This has been done in order to take account of the interaction through the EU and global economic governance institutions. As argued below, relations between the UK and China are substantially affected by these two levels and much of the interaction is indirect, through either the EU or an IO. It therefore makes sense to include these levels in the model. There are four levels in play – two domestic games, the bilateral relationship, EU-China relations and global governance institutions. This section will go through each of the five games, reviewing the literature and relating it to this model, before explaining how the four levels fit together.

### **2.5.2 The UK Domestic Game**

The UK is a parliamentary democracy where the main power lies in the House of Commons. The government is led by the Prime Minister, almost always the leader of the party that wins the most seats at the last general election. From the 1997 general election until 2015, there were only three Prime Ministers – Tony Blair, Gordon Brown and David Cameron – all of which had reasonably similar approaches to foreign policy; there was no sudden ideological shift, except perhaps on the EU. The government is split into departments, of which the Treasury has historically been the most powerful (Reynolds 2000: 42-47). For simplicity, Putnam's model assumes that the government is a single actor.

British domestic policy making has been theorised in a number of different ways. Classical pluralist approaches emphasise the policy networks that create government policy and assume that power is dispersed throughout society (eg Dahl 1961; Rhodes 1997). This is unsuitable for this project because so few people in the UK have a strong direct interest in policy towards China. Another approach is constructivism, which focuses on the role of norms and ideas in constructing perceptions of economic phenomena (eg Hay 2010; Clift and Tomlinson 2008). Thin constructivism is a useful tool in this project to explain China's imagined power, however constructivism is not suitable for a stand-alone theory for the UK game because it incorrectly minimises material economic interests. Another alternative is Marxism, which focuses on the class structure (eg Burnham 2006). The problem with this perspective is that it ignores the agency of individual actors.

The approach that this thesis takes with regard to the UK domestic game is neo-pluralism. This revises the classical pluralist view of dispersed power to the more realistic position that, while anyone can influence government, policy making is biased towards corporate interests. Charles E. Lindblom (1977: 170-172) discusses "the privileged position of business", where corporate executives play a role in government that is "unmatched by any leadership group other than government officials themselves". Robert Putnam (1977) talked of the policy making process being dominated by a small group with technical expertise. Over the past forty years,

the UK government were keen to appeal to business both when the Conservatives and New Labour were in power (Grant 2008: 205). Business interests became influential over foreign policy and have been formally integrated within diplomatic systems (Lee 2004). This 'privatisation of authority' (Cutler et al 1999; Hall and Biersteker 2002; Williams 2004) means that UK policy towards China is increasingly made by governmental economic agencies and the key actors are increasingly non-state economic actors (Breslin 2004).

This is also similar to the idea of a policy community. Rhodes (2006: 427-428) lists the characteristics of a policy community as being a limited number of community members, good interaction between all community members, consistency in values and "exchange relationships" in which all members control some resources. This stands in contrast to an 'issue network' (McFarland 1987), which involves a large number of actors each with less reliable access. This model is relevant to the UK because there is only a few actors that seek to influence policy towards China. Kerry Brown (2019: ch3) talks of "the China circle in Britain", which is a small number of people in academia, the civil service, journalism and business. Each of these groups has a direct interest in UK-China relations, and for the most part the objective is having liberalised relations to maximise profit. Brown (2019: 74) argues that "the general public does not feature in this community", as they do not have any direct interest. This is true as a broad statement, although the public did take an interest during the 2015 Xi visit and certain members of the public take an interest in specific issues, such as when they lose their jobs.

This neo-pluralist approach works because the dominant issues assumed in the theory – corporate interests – are the same issues that have empirically been the most important in UK-China relations. The economic and financial dialogue meetings, held approximately annually since 2008, have been led by the Chancellor. In contrast, the human rights dialogue was chaired by a junior foreign office minister, as discussed in chapter four. Corporate interests have been crucial to trade and investment links, as discussed in chapters five and six, and the domestic pressure for greater financial links has come from the City of London itself, as discussed in chapter seven. Non-corporate domestic interests, such as human rights, have been less effective, confirming the bias assumed by neo-pluralist theory.

This brief model of neo-pluralism is useful for explaining the evolution of UK-China relations because of the constraints that were placed on the UK negotiators. As explained earlier in this chapter, Putnam's two-level game model theorises that any international agreement must be acceptable to domestic politics. The strength of corporate and financial interests in domestic politics meant that the UK's negotiating position vis-à-vis China must be favourable to those interests. This is particularly true given the perceived volume of economic opportunities available in the Chinese markets. On the other hand, while human rights campaigns have strong vocal support in Parliament, they are much less likely to be able to veto a government approach. The UK domestic game thus provides a constraint on UK-China economic negotiations.

### ***2.5.3 The Chinese Domestic Game***

The Chinese political system has very different institutions and processes compared with the UK. Whereas the UK government receives legitimacy from winning general elections, the Chinese government is not subject to elections and must receive legitimacy in other ways. One of the main methodological problems with studying Chinese political economy is that it can be a "black box" (eg Sufian and Habibullah 2011; van der kaa et al 2013; Wang et al 2015) so the decision making processes are very opaque. Much of Chinese political decision making is based upon informal networks that cannot be studied from a distance (Dittmer 1995; Wang 2000). This is also one of the reasons why UK businesses attempting to break into the Chinese market have often been less successful than predicted, as will be discussed in the chapters on trade and investment. What is able to be said about Chinese domestic politics is the ways in which the Chinese government maintains legitimacy and how China's foreign policy seeks to strengthen those.

The main way in which the Chinese government has achieved legitimacy is by having a strong economy and improving living standards for hundreds of millions of Chinese people (Wang 2005; Perry 2008; Zhao 2009). It is therefore natural that one of the central objectives of Chinese foreign policy is aiding and furthering China's



economic growth. The ways of doing this has changed somewhat over the period, as China's economic engagement with the world has moved from exporter towards investor. Up until the financial crisis, increasing trade with the West – including the UK – was a priority. Since the financial crisis, China has sought to improve its domestic economy by diversifying its global investments and improving its financial system. These are China's primary objectives of foreign relations, including with the UK.

Closely related to the economic benefit is China's concerns over resourcing. China has 1.4 billion people and is growing economically, which has led to China's demand for resources increasing and Chinese demand will continue to increase in the future (Garnaut 2012; Nathan and Scobell 2012: 276). In order to meet this demand, and prepare for future demand increases, China has exercised geopolitical influence to ensure the safety of supply chains that meet domestic demand: China's role in the "new scramble for Africa" is to a large extent to do with resources (Alden et al 2008; Taylor 2009; Carmody 2011); and China's turn to Central Asia for energy has created a new nexus (Swanstrom 2005; Fazilov and Chen 2013). While the UK cannot directly provide China with substantial amounts of raw materials, it can provide expertise and commercial facilitation. One of the reasons why China has worked with and invested into the British oil and gas company BP is BP's expertise in trading, and the availability of their training and risk-management services (Hamilton and Zhang 2012: 134).

However, like the UK, China's foreign policy objectives are not just economic. Part of the Chinese government's legitimacy comes from ideology (Zeng 2015), which contains nationalism. Issues relating to ideology and nationalism have been found in China's foreign policy making. For example, Jee Eun Lee and Sophie Meunier (2015) have found evidence of a "Dalai Lama effect" – when national leaders meet with the Dalai Lama, there is a temporary reduction in Chinese FDI inflows to that country. This shows that China have politicised economic flows, and that nationalism affects foreign economic policy making, which is the result of the Chinese domestic game. This is discussed in chapter four on human rights.

These drivers of Chinese foreign policy are considered by the Chinese leadership when formulating its negotiating position. However, the overall win-set is wider than for the UK because of the stronger position that the Chinese government is in vis-à-vis Chinese society than the UK government. China is not a democracy so – at least through formal channels – there is not the same level of scrutiny compared with the UK. There is more pressure on the legitimacy of the Chinese government compared with twenty years ago because of the falling rate of economic growth. This can be theorised by a shrinking win-set, with less room to manoeuvre for the government.

#### ***2.5.4 The European Union Game***

The third level of the model is the European level, which fits into a level that is above a state but below global governance. As Shaun Breslin (2010) argues, one of the major difficulties with studying Europe as it relates to China is defining what Europe is. Europe is a geographical continent, a collection of around 730 million people (UN 2017) and the total of approximately fifty countries. In political terms, the European Union (EU) is often what is referred to by 'Europe'. Despite the Euroscepticism that resulted in the UK's 2016 referendum result to leave, the EU has had significant affected UK-China relations throughout the 1997-2015 period, particularly on trade where the EU has competence.

An obvious feature of the EU is that it has changed throughout the period. The number of EU members has increased from fifteen in 1997 to twenty-eight in 2015, after ten Eastern European countries joined in 2004, two joined in 2007 then Croatia joined in 2013 (EU website). Since 1997, three EU treaties have come into force: the Amsterdam Treaty (1999), the Nice Treaty (2003) and, most importantly, the Lisbon Treaty (2009). These treaties have altered the way in which the EU operates, and to a small extent changed the 'game' being played. The Lisbon Treaty strengthened the EU's foreign policy making power, adding a European External Action Service led by a High Representative. As part of the four-level game, a theorisation of EU integration is required.

Different approaches to EU integration have been theorised that seek to explain how the relationship between states and the EU has changed. One theory is neofunctionalism, which emphasises the growing economic interdependence between states and widening integration (Haas 1958; Stone Sweet 2004). Ben Rosamond (2000: 51) says neofunctionalism “might be thought of as an attempt to theorise the strategies of the founding elites of post-war unity”, which “represented a direct rejection of the idealism of the federalist movement”. A major problem with neofunctionalism is that it ignores the power of states and the influence they have. From the very start of the EEC, much of EU integration has been driven by the “Franco-German axis”, the close relationship between the governments of the two largest founding members (Hendriks and Morgan 2001).

A more convincing theory is liberal intergovernmentalism, which treats states as the primary actors in the EU integration process. Andrew Moravcsik (1991) argues that the EU has integrated because of converging interests of member states, particularly France, Germany and the UK. Based on the assumptions and logic of liberal IPE, Moravcsik (1993) argues that states are rational so will integrate when the benefits of cooperation outweigh the costs. On trade, for example, the benefits of the single market outweigh the costs of having to converge on market rules. This explains why the EU has been given competency of some issues, but not on others, since the areas of EU competence are areas where state’s national interests align.

Liberal intergovernmentalism takes the liberal approach on the linkages between domestic politics and international relations. Moravcsik (1993: 481) says that:

“National interests... emerge through domestic political conflict as societal groups compete for political influence, national and transnational coalitions form, and new policy alternatives are recognized by governments.”

For Moravcsik, negotiation over EU treaties comes in two stages. First, there is the domestic stage where national preferences are formed, then the second stage occurs when nations bargain to advance their own preferences. This is very similar to Putnam’s (1988) two-level game model of national governments playing a domestic game and an international game simultaneously. In theory, analysing the

EU properly when it has twenty-eight member states means looking at twenty-nine separate games: the twenty-eight domestic games plus the one, big international bargaining game. This is not necessary in this thesis, since the focus is on UK-China relations and the EU is only discussed insofar as it relates to that.

A challenge to liberal intergovernmentalism comes from ‘the governance approach’, in which “the main analytical focus is on investigating the impact of the EU's political System” (Bergmann and Niemann 2015: 7). Rather than focusing on EU states, the governance approach analyses a wider range of actors to seek to explain EU decision-making processes. Crucially, this accounts for “the increasing involvement of EU organisational actors (chiefly the Commission)” (Smith 2008: 183). EU foreign policy making is therefore a dependent variable, rather than an independent variable that is dependent on national governments. In this approach, Joachim and Dembinski (2011: 1164) describe the characterisation of EU foreign policy as intergovernmental as “inappropriate”, as they find NGOs have contributed to EU foreign policy rules and norms.

A key debate in the EU foreign policy literature therefore is about the extent of the EU's actorness. Sjöstedt (1977) defines actorness as the “capacity to behave actively and deliberately in relation to other actors in the international system”. A proponent of liberal intergovernmentalism, such as Moravcsik, would generally not theorise the EU as having actorness independent of national governments; advocates of the governance approach, such as Mike E Smith, would put far greater emphasis on internal EU policymaking. The theoretical framework in this thesis follows the former approach. To explain the nuance of this, it is helpful to follow Delreux (2014: 1018) in splitting actorness into three criteria: “recognition (its acceptance by other actors in the international system); authority (its legal competences); and autonomy (the EU negotiator's independence from the member states)”. With regard to China, while the EU has recognition from China and legal authority on some of the key issues, there is a very low degree of autonomy from member states. These three criteria will be gone through in turn.

On the first criterion, the EU has clear recognition from China as an international actor. There have been diplomatic relations between the Commission and the

Chinese government throughout the period, including exchanging ambassadors. The Maastricht Treaty in 1993 established the Common Foreign and Security Policy, which was built on in the 2009 Lisbon Treaty that established an EU legal personality in international affairs and an institutional structure for its external service (EU website). The Lisbon Treaty also established a High Representative of the Union for Foreign Affairs and Security Policy to lead on foreign policy. There has been continued EU-China dialogue and cooperation on a range of important global issues. As will be discussed in chapter four, there is an EU-China human rights dialogue that is independent of EU nation states' separate human rights dialogue with China. As will be covered in chapters five and six, formal EU-China trade and investment dialogue also takes place.

In addition, the EU and China have also cooperated on issues of global importance. The EU and China have formed a "strategic partnership" (Moller 2002; Sautenet 2007; Casarini 2006; Laursen 2011; Scott 2014), and have cooperated on a whole range of issues, including energy (Zhao et al 2011; Holzer and Zhang 2008; Lema et al 2011), climate change (Men 2014), space policy (Johnson-Fleese and Erickson 2006), geopolitical issues (Scott 2007), education (Yao and Steemers 2009; Robinson and Yi 2009; Pinna 2009), scientific research (Zhou and Glanzel 2010), aviation (Lan 2011), agriculture (Freeman et al 2008) and intellectual property rights (Mertha 2005). Being an EU member, the UK was inherently affected by these partnerships.

On the second criterion, the EU has legal competency on several key issues that affects relations with China. The most important of these is trade, for which the EU has full competency as will be discussed in chapter five. On investment, the EU's competence is less clear than with trade but has grown over time, particularly with the 2009 Lisbon Treaty. On finance, the EU has competence over intra-EU financial transactions, but this is of little relevance to UK-China relations as will be argued in chapter seven. On human rights, EU membership affects domestic human rights issues but not on foreign policy issues. Therefore, the EU has competence on several issues to differing extents, the clearest of which is trade.

The third criterion – the EU’s autonomy – is where EU actorness falls down. While the EU is a separate legal entity, with regard to policy towards China it is difficult to identify any example of where the Commission has gone against member states. In particular, this thesis will argue that EU policy towards China is heavily determined by what were the three most powerful countries prior to the UK’s exit – Germany, the UK and France. On occasions where member states were aligned, such as over China’s WTO accession, the Commission followed the views of member states. On issues where member states were divided, such on a possible future trade deal, the EU was ineffective and the status quo prevailed. This does not imply an autonomous EU; on the contrary, it implies a highly intergovernmental EU.

Some scholars have suggested that the Commission has autonomous power as an agenda setter (eg Bailer 2004; Blom-Hansen 2008; Hartlapp et al 2010; Vanhoonacker and Pomorska 2013), but this thesis does not identify anything raised by the Commission that was not raised either by a member state, or by a foreign country such as the US. Trade issues, including WTO accession and Market Economy Status, were on the agenda by virtue of being international issues. There are no human rights issues raised by the Commission that have not been raised by member states or by the UN or US. Finance is also heavily international in nature.

That is not to say the EU does not have power. On foreign relations, the EU has two main types of power. The first is “market power” (Damro 2012), which uses access to the large EU market as leverage in negotiations. This is institutionalised in the WTO, where the EU represents all EU states, but is usually used in trade agreements. The second type of power is “normative power” (Manners 2002), which occurs when the EU changes the conception of ‘normal’ in international relations. With regards to relations with China, like with most countries, market power is the biggest source of power for the EU. As the world’s largest market, the EU has leverage against China that is only matched by the US. Numerous authors have argued that the relationship is an important axis for the twenty-first century, and that the EU and China might – along with the US – form a “G3” (Scott 2007; Griffin and Pantucci 2007; Meunier 2012; Men and Shen 2014: 1-2; Pardo 2014). The EU’s power is the result of its large market, rather than the actions of the Commission per se.

### Europe-China Relations outside the EU

The EU does not have full competency on foreign policy issues, which is why EU member states still require their own independent foreign policies. Therefore, Europe-China relations are not simply EU-China relations, but also has to consider China's bilateral relationships with the powerful EU countries, particularly Germany, France and the UK. This is important because there is variation between how the EU, Germany, France and the UK approach China and East Asia generally (Simon and Klose 2015). A full understanding of Europe-China relations can only be gained by knowing this variation, and recognising EU competences.

The structure of China's relationship with individual states is that there is one China and many EU states. This gives China greater power because of the potential for a "bidding war" or "race to the bottom" as EU countries compete for Chinese investment (Meunier 2014a; 2014b; 2014c). Using Keohane and Nye's (2012) conception of power, this makes EU countries sensitive to China's decision making as if China chooses to move investment elsewhere then the country would likely lose the associated jobs and capital. This sensitivity is most obvious in the chapters on human rights and investment, but also comes up in the finance chapter. It is not an issue in the trade chapter because the EU has exclusive competence in that area.

#### **2.5.5 Global Governance**

Global economic governance is the fourth and highest level of the game. It is not normally incorporated into two-level game-style models, presumably because the countries have to have significant influence over global governance to truly make it part of the game. This project is different because both China and the UK can be seen to have had a significant impact upon global economic governance during the last twenty years. China significantly altered global governance, first by joining the WTO, then by setting up rival institutions such as the Asian Infrastructure Investment Bank (AIIB). For the UK, influence on global governance institutions ensures that the UK is kept on China's radars, certainly more so than if the UK did not have such

influence. Global governance organisations also affect EU-China relations (Christiansen 2016).

Global governance organisations play an important role in the shaping of domestic politics and bilateral relations. Hawkins et al (2006) use principle-agent theory to explain the reasoning for why states delegate authority to IOs, similar to Moravcsik's (1991; 1993) liberal intergovernmentalism in the EU game. States, the principle, delegate authority to an IO, the agent, to coordinate on issues that benefit from cooperation. As argued by liberal institutionalists (Keohane 1984; Martin 1992), cooperation can serve states interests by being mutually beneficial as many issues are positive-sum. Delegating to an IO avoids coordination problems that, as with the prisoner's dilemma, can lead to everyone being worse off.

In addition, delegating to IOs can be a useful tool for achieving domestic policy. Hawkins et al (2006: 19) says "domestic coalitions can seek to lock in their domestic benefits through international agreements". The winners of domestic political conflict attempt to create institutions that consolidate their advantages and make it more difficult for future governments to change. This could apply to trade, when an industry that is affected by international competition locks in trade policies through IOs. In addition, delegation can also serve as a useful domestic economic management tool, allowing national governments to appeal to the knowledge and authority of IOs. Chris Rogers (2015: 301) has argued that the technocratic approach adopted by the G20 "provides British policymakers with a discourse of international expert consensus that reinforces domestic economic strategy". Thus, an IO was useful to the government for domestic political purposes.

The global governance level plays a role in all four issues. On human rights, the actors that can best hold China accountable are IOs that do not suffer from the 'race to the bottom' problem that individual states have. On trade, relations were affected substantially by China's entry into the WTO, which lowered China's trade barriers and dramatically increased China's trade with the rest of the world. Both the EU and China stood to benefit from this, which is why they agreed to it. Investment is the topic which IOs play the smallest role, although it is also affected by WTO rules. On finance, the AIIB is threatening to challenge the IMF as an international financial



institution with different norms. To ensure the effective operation of international finance and to remove negative externalities, banking rules are set globally by the Basel Committee. In these ways, IOs facilitate and enforce mutually-beneficial cooperation between major powers, including the UK and China.

### ***2.5.6 Putting the Four Levels Together: The Bilateral Game***

The bilateral economic relationship between the UK and China is the focus of this project, and the game is set-up to help explain it. The bilateral relationship includes non-economic issues, such as a human rights dialogue, and economic flows, such as trade, investment and financial flows. Non-economic issues, such as human rights, are relevant to economic flows because, as shown in the two domestic games above, non-economic pressures influence the government's foreign policy. The bilateral relationship is a negotiation between the two countries where they attempt to satisfy domestic pressures in the framework provided by regional and international organisations.

Keohane and Nye's (2012: 10) concepts of sensitivity and vulnerability are useful to understanding the power dynamics in the UK-China relationship, and therefore the bargaining power that each state has. In the 1990s and early 2000s, China was engaged in a 'race to the bottom' competing with South East Asian countries to produce and export cheap goods to the West (Pilat et al 2006). This made the Chinese economy vulnerable to production decisions made by UK businesses, but not so the other way around because UK businesses could simply move production to another country. In the 2010s, this economic vulnerability has reversed. It is now the UK economy that is vulnerable to Chinese investment decisions, and Chinese investors not vulnerable because they can invest in other countries. Thus the substantial growth of and changes to the Chinese economy have given China greater bargaining power in relations with the UK. The shift in negotiating power is clear throughout the empirical chapters.

The five games on four levels fit together naturally on top of each other. The two domestic politics games sit at the bottom, the bilateral relationship above that, the

EU above that with global governance institutions at the top. A diagram of the way they fit together is shown in figure 3. The solid lines show the five games that are directly relevant to UK-China relations; the dotted lines show the impact that other countries have on UK-China relations which, although also important, is only indirect. The purpose of the model is to identify and organise both the domestic factors and international factors that affect UK-China relations. This helps explain the main drivers of change that have occurred, which is the research question.

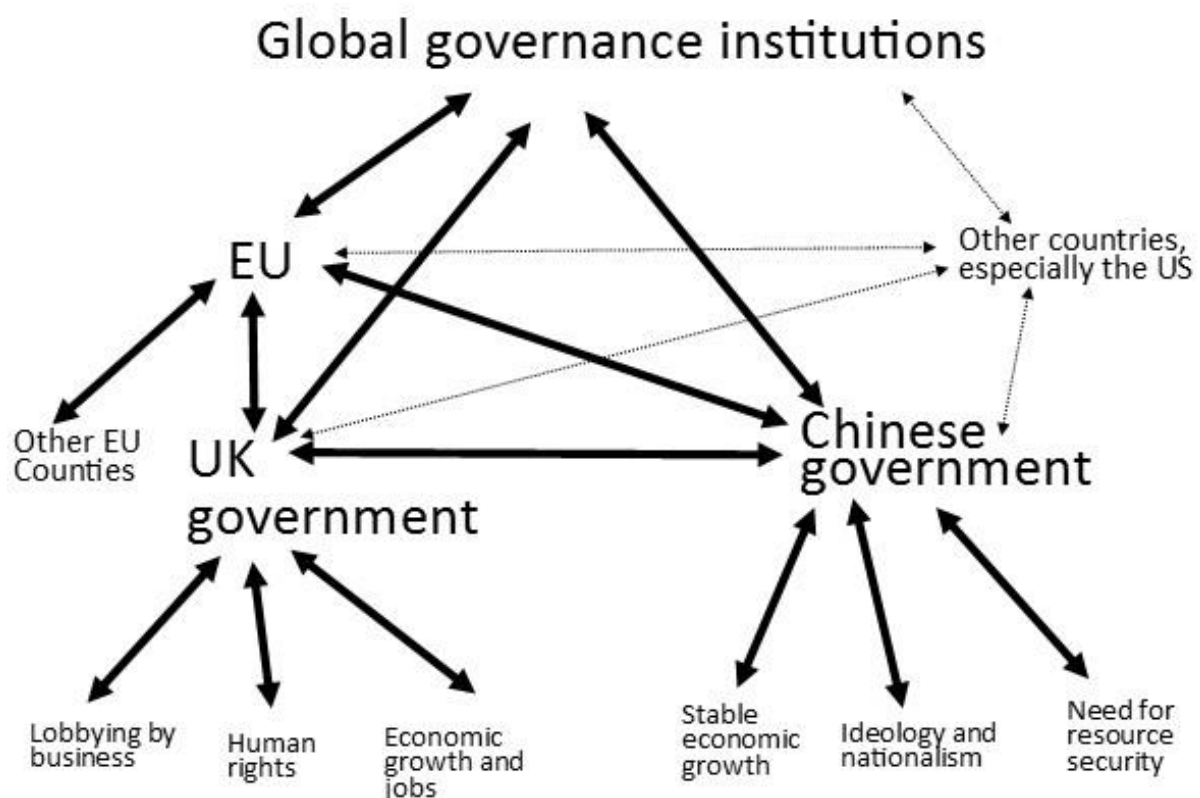


Figure 3 – The four-level game

Most importantly, the four-level game demonstrates the constraints that exist on UK-China economic relations. All four levels impact relations, either by providing domestic constraints on governments or institutional constraints at international level. As explained earlier in this sub-section, the domestic games are important because they determine the 'win-set' of each country's negotiators. Putnam's (1988) model is based on the idea that an agreement between states must be acceptable to the

domestic constituency. For UK-China relations, that means that agreements between the two national governments must be acceptable to both UK domestic politics and to Chinese domestic politics. For this reason, addressing the domestic politics of both the UK and China is an important component of answering the overarching research question in this project, and therefore takes up time in all four empirical chapters.

International factors also play an important role in constraining bilateral negotiations for two reasons. Firstly, the international political context and the relative power strengths between the two countries affect the distribution of the joint gains from the international bargain. All things being equal, one would expect that a more powerful country, with greater control over global economic governance institutions, would receive a higher proportion of joint gains from a bilateral agreement than a less powerful country. This is because a powerful country can alter institutions to suit its interests (Hawkins et al 2006: 22). There was a power shift – both a material power shift and a perceived shift – towards China, which gave China greater negotiating power in relations with the UK and with global governance organisations. This further shifted the power towards China in bilateral bargaining.

The second constraint that regional and international levels provide on bilateral relations is through international law. When states sign international agreements or join international organisations, they make commitments about their future behaviour that acts as a constraint on national government policy. For some IOs, including the EU, this is not only a constraint but an outsourcing of an entire area of policy. For example, the UK could not have an independent trade policy whilst being in the EU. International institutions and international law are powerful because there are high costs to states of breaching agreements (Keohane 2005). The upper two levels in the four-level game will also be discussed in the empirical chapters since they shape and constrain bilateral relations.

## **2.6 Conclusion**

This chapter has set-out a model of the global political economy that is predominantly liberal but which contains an element of thin constructivism. The version of liberal IPE used is grounded in Keohane and Nye's (2012) ideas of "complex interdependence" that effectively theorises the growing interconnectedness of the world economy. By focusing on individuals, it convincingly explains the winners and losers from globalisation that affects modern politics (Rodrik 1997b; 2011; 2018). Explaining globalisation is necessary to frame UK-China economic relations because the relationship is inherently affected by wider global economic trends around trade liberalisation and technology. Thin constructivism is a useful add-on to liberal IPE and explains the dialectical relationship between the material and the ideational (Marsh 2009). This is particularly useful in analysing the "imagined power" (Breslin 2015) that China has, as China's current material power is exaggerated by the widespread perception that it is a future superpower.

Using this theoretical underpinnings, a four-level game model is built, based upon Putnam's (1988) two-level game model. There are five games on four levels: the UK domestic game and the Chinese domestic game on the bottom; the bilateral game on level two; the regional game on level three, which focuses on the EU; then global governance on the top level. Both the domestic games and the regional and international games affect the bilateral relationship and are therefore necessary to study. The two domestic games determine the preferences of each government, and in the case of China have changed as the economy has grown. The regional and international games frame the bilateral relationship, and have also changed as China has joined the WTO and set-up the AIIB.

The theoretical perspective discussed in this chapter helps organise knowledge and is vital for making sense of the empirical observations reported in chapters four to seven. UK-China relations with regard to human rights, trade, investment and finance will be analysed using this theoretical framework and four-level game model. Insights into how each domestic game has changed, and how the regional game or global governance has changed will inform the evolution of the bilateral game. Broader observations about globalisation that support the liberal view are also made. However, before the empirical chapters, the thesis summarises the main events and trends of UK-China relations in chapter three: overview of key issues.



## **Chapter 3: Overview of Key Issues**

### **3.1 Introduction**

Chapter two built the theoretical model for this thesis. It began by explaining why liberal IPE is such a suitable model to explain the increasing interconnectedness of the global political economy. In particular, Keohane and Nye's (2012) model of 'complex interdependence' explains how decisions made in one part of the world affect other parts. An element of thin constructivism was added to this to explain norms, a particular issue because of China's "imagined power" (Breslin 2015: 236). With this theory of the global political economy, a four-level game was built that extended Putnam's (1988) two-level game. The game contains five games on four levels: the UK and China domestic games; the bilateral game; the EU game; and the international game. The model is useful for identifying changes to bilateral relations and will be used throughout the thesis.

This chapter gives an overview of the key issues and events that have affected UK-China relations. UK-China economic relations evolved through different stages and was changed by three key turning points: the Hong Kong handover, the global financial crisis and the 2012-13 'freeze'. The chapter is not intended to simply be descriptive, but also to explain how different trends fit into different periods. Specific events can be more fully understood if they are placed within a broader political and historic context. This chapter divides 1997-2015 into five stages: the Hong Kong handover in 1997; the focus on trade 1997-2008; the response to the global economic crisis 2008-2012; the 'freeze' in 2012-13; and the warming of relations 2013-2015.

Through an analysis of these five stages, several points will become clear. The first is that different issues become prominent in different periods, and this reflects the changing economic relationship. Before the handover on 1<sup>st</sup> July 1997, Hong Kong was the main issue. Leading up to 2007, trade was the main issue, then financial and economic stability when the world economy was in economic crisis. Since the

economic crisis, investment and finance have become issues in UK-China relations whereas they were not before. This shift in the economic focus of the relationship mirrors the focus of China's relationships with other Western countries, which suggests the changes in relations were driven by the Chinese side. Human rights was also an issue throughout the period, although less important than the economic issues and an issue that reduced in prominence as time went on and China became more powerful.

The analysis presented in this chapter begins to answer the question of how China's economic growth has affected power relations between the UK and China. As discussed in the introduction, China's economy went from being smaller than the UK's in 1997 to four times larger in 2015. This is an overarching theme throughout the thesis and manifests itself in several ways. The changing economic focus of relations are to a large extent driven by China's changing market power, preferences and economic needs. China's greater economic size gives it the confidence to be more assertive, which makes the UK being more vulnerable to China's decision making. However, this material change is exaggerated by perceptions of China within the UK government.

Finally, while the growth of China is main cause of the changes in relations, it was not the only cause. There were a range of causes, both domestic, national and international that affected relations, as will be explained in this chapter. The four-level game built in the previous chapter is useful to explain this because it disentangles each of the games and allows for a more precise analysis. Like with the issues, different games became prominent at different times and for different reasons. Setting out this change in prominence is one of the central purposes of this chapter.

### **3.2 Stage 1: Hong Kong Handover (1997)**

This project starts in 1997, the year in which Hong Kong was handed back to China after a century-and-a-half of British control. As Peter Ferdinand (2000: 29) argues: "it would not be a major exaggeration to say that until 1 July 1997, British relations with

China were always coloured by Hong Kong". Of course there were other issues before 1997 that affected the UK-China relationship, such as trade, but Hong Kong was particularly important for both countries. For the UK, it was the last remaining substantial overseas territory but also economically advantageous to have strong links with what became a global economic and financial centre. For China, Hong Kong was seen as a symbol of the humiliation faced in the early nineteenth century, when Hong Kong was taken by the British. However, China did also benefit economically from Hong Kong because it provided finance and facilitated trade (Sung and Song 1991).

Britain's initial colonisation of Hong Kong had its origins in the Opium Wars, which arose from a dispute over China's blockade and confiscation of opium imports from British traders (Hanes and Sanello 2004). As Tsang (1997: 1-2) argues, "In the nineteenth century, Britain's fundamental interest in China was trade". The Chinese government stood against that interest and was confronted by the British using force. Both the First and the Second Opium Wars were quickly and decisively won by the British because of their superior weaponry despite the geographical disadvantage of being thousands of miles away from Britain. China was forced to sign the Treaty of Nanking in 1842 and the Convention of Beijing in 1860 that, among other things, gave the British control of Hong Kong as compensation for China's opium policies (Chang and Chuang 1998: 19-20; Tsang 1997: ch1). In 1898 Britain imposed the Convention for the Extension of Hong Kong Territory upon China, which gave Britain a ninety-nine-year lease of the New Territories.

The Opium Wars and subsequent treaties had a long-term impact on UK-China relations beyond Hong Kong because of the Chinese anger this period caused. China resented these "unequal treaties" since, in China's view, Britain had unfairly taken land from China with no obligations in return (Chang and Chuang 1998: 20-22). The ceded land was not the only thing that caused anger. Eighteen million silver dollars of compensation was required from the Chinese for the confiscated opium (Deng 2008: 332). In 1860, British and French troops burnt Beijing's Old Summer Palace to the ground after looting its valuables (Weatherley and Rosen 2013). The anger caused by China's treatment during this period continues to play a role in how China constructs its history in the present day (Wang 2005). Weatherley and Rosen



(2013) find that the CCP have encouraged focus on the burning of the Old Summer Palace to strengthen nationalism, a key source of legitimacy for the CCP. David Cameron (2019: 157-158) says that for China, the UK was “still their oppressors from the nineteenth-century Opium Wars, and awkward neighbours during the years when Hong Kong was a British territory”.

Hong Kong remained under British control and saw incredible economic growth in the second half of the twentieth century, along with the other ‘Asian Tigers’ (Paldam 2003). This changed the nature of Hong Kong significantly: at the start of the nineteenth century Hong Kong was little more than a fishing village; the later part of the twentieth century transformed Hong Kong into a global financial and economic centre. There is debate over why Hong Kong grew so much, with some scholars crediting free market policies and low taxes (eg Friedman 1998) and others pointing to Hong Kong’s industrial policy (eg Rodrik 1997a; Chang 2006). Regardless of the cause, Hong Kong’s economic success benefitted both the UK and China as a source of finance and a major trading port.

In the late 1970s and early 1980s, the 1997 lease expiry date was approaching and therefore discussions were started on the status of post-1997 Hong Kong (Craddock 1994: 164-165). The typical lease for property in Hong Kong was fifteen years and businesses wanted certainty about Hong Kong’s political system. The meeting between the British Prime Minister, Margaret Thatcher, and China’s paramount leader, Deng Xiaoping, in September 1982, in which both sides set-out their position, was a precursor to the two-year negotiating period between 1982 and 1984. China was determined to regain sovereignty of Hong Kong, while Britain preferred for Hong Kong to remain under British control (Thatcher 1993: 259-262). When Britain accepted that the Chinese were not willing to negotiate on sovereignty, Britain turned its focus to ensuring the continuation of political and economic freedom in Hong Kong (Thatcher 1993: 489).

The result of the negotiation on Hong Kong was the 1984 Sino-British Joint Declaration. This agreement stated that sovereignty over Hong Kong would be restored to China with effect from 1<sup>st</sup> July 1997, but that the “current social and economic systems in Hong Kong will remain unchanged” for fifty years after the

handover (Joint Declaration 1984). That means that between 1997 and 2047, Hong Kong should remain capitalist and should continue with the system of elections it had. The Declaration was considered a success by much of Parliament. The Shadow Foreign Secretary Dennis Healey told the House of Commons that:

“the agreement must be regarded as the most outstanding achievement of British diplomacy since Lord Carrington concluded the Rhodesian negotiations and the state of Zimbabwe was born” (House of Commons 1984).

Some wished that Hong Kong could remain British and not become Chinese. However, a handover of sovereignty was inevitable given the changes in global power dynamics. China could not be pushed around so easily, particularly given how reliant Hong Kong was on China for water. The Royal Navy was no longer the world's policeman as it was during the time of the Opium Wars, and global norms had changed so that there was more emphasis on international rules. China's desire for Hong Kong to be returned meant that there was no option for Britain to retain sovereignty. Margaret Thatcher's decision to focus on political freedom was the correct decision, given the circumstances, and the agreement was as good as could have been achieved.

The Tiananmen Square protests of 1989, and the resulting massacre, changed opinions in Hong Kong because of fears of what Chinese sovereignty would bring. Hong Kong saw mass protests in support of the Tiananmen Square protesters and of democracy in China (Chang and Chaung 1998: 133; Tsang 1997: 161-162). As a result of these concerns, a Hong Kong Bill of Rights was introduced and a deal was reached with China increasing the number of directly elected seats in the legislative council of Hong Kong (Tsang 1997: 171-172). In order to support democracy in Hong Kong, Prime Minister John Major appointed Chris Patten, former Chairman of the Conservative Party, as the last Governor of Hong Kong. Although there were said to be risks of appointing a politician (Patten 1998: 14-15), John Major appointed him because “he would want to entrench the maximum amount of democracy in the territory before it returned to Chinese sovereignty” (Major 1999: 505). Patten was certainly a different choice to a career diplomat, as most of the other governors had been.

To the Chinese, the 1990s focus on human rights was seen as cynical. Kwarteng (2010: 387) argues that the democratisation “in the Chinese view, went against 150 years of British tradition”. The Chinese government agreed to continue Hong Kong’s political and economic systems as they were in 1984 and for Chris Patten to attempt to democratise was against the spirit of the agreement. In hindsight, it would have been much better if the British had started implementing democratic reforms after the Second World War, rather than waiting until the 1990s. This would have been seen as less opportunistic, and would have given Hong Kong a deeper democratic culture.

The handover finally arrived on 1<sup>st</sup> July 1997. The ceremony involved a firework display and a 4,000-guest banquet, before the British flag being lowered at midnight (BBC News 1997, 1<sup>st</sup> July). The Hong Kong handover was particularly important for China as it symbolised the end of European imperialism in China; after the Macau handover in 1999, there were no European colonies left in Asia (BBC News 1999, 20<sup>th</sup> December). Tony Blair (2010: 126) recalls how Chinese president Jiang Zemin had explained that this was a new era in UK-China relations as “from now on, the past could be put behind us”. Blair believed that Jiang meant this, and relations did improve after this point. This is the reason why this thesis starts in 1997 – because a new era of relations began.

The success of the Hong Kong handover can be seen by the stability of Hong Kong during the period following it. The handover itself was entirely peaceful, contrary to the expectations of some observers. Following the handover, Hong Kong saw fifteen years of quite remarkable stability in which Hong Kong ceased to be an issue in bilateral relations between the UK and China. It was only with the 2014 democracy protests against China’s alleged interference in Hong Kong electoral system that Hong Kong re-emerges as a significant issue. This normalised UK-China relations and allowed the focus of the relationship to move onto other issues.

### **3.3 Stage 2: Focus on Trade (1997-2008)**

### **3.3.1 Moving On from Hong Kong**

Following the 1997 handover of Hong Kong, the tone of the relationship changed as both sides wanted to move on to other issues. Hong Kong has caused tension and disagreement and so it was natural to want to move onto other issues. 1997 was also a significant year for the UK side as New Labour won a landslide election victory and ended eighteen years of Conservative rule. On foreign policy, a change was signalled since one of the first things new Foreign Secretary Robin Cook (1997) said was that he wanted an “ethical dimension” to foreign policy. Although this was later backtracked on, 1997 was the year of new beginnings.

To move on from Hong Kong, the respective leaders swapped visits in 1998 and 1999. Tony Blair visited China in October 1998 and the UK and China agreed a “comprehensive partnership”, whilst agreeing trade deals and setting up a trade forum (BBC News 1998, 6<sup>th</sup> October). Blair stressed the importance of both trade and human rights, saying that “trade is very important between China and Britain but not necessarily more important than human rights”. Human rights were discussed openly, with Chinese Premier saying that “You can feel free to talk about anything...Nothing will offend us”. The tone of discussions was warmer than in the preceding fifteen years.

Trade was also high on the agenda during the return visit, when President Jiang made a state visit to the UK in October 1999 (*Guardian* 1999, 20<sup>th</sup> October). Trade was particularly relevant in the context of China’s proposed WTO entry, which was being finalised at that time and which the UK supported. Human rights were mentioned, including with reference to Tibet. The Dalai Lama had visited the UK earlier that year in May 1999 and met with Tony Blair (BBC News 1999, 20<sup>th</sup> December) and, although China were disappointed, it did not hurt relations. In the meeting with Jiang, Hong Kong was also mentioned, although it was not a primary issue as it had been in previous bilateral meetings.

Breslin (2004) argues that there were a number of reasons why Hong Kong disappeared off the agenda. The handover was smooth and Hong Kong remained stable, with China broadly keeping its promises not to intervene politically. Although

the handover ceremony itself was the subject of media attention, the lives of most Hong Kong people did not change as a result of the handover. In addition, China – along with the rest of East Asia – soon became occupied with the Asian financial crisis, which moved the focus of discussions on Hong Kong from democratisation towards economic concerns. This change of emphasis on Hong Kong mirrors the change of emphasis across the entire relationship.

### **3.3.2 Trade**

One of the key objectives of the British government during this period was trade access. China had a vast market, which continued to grow as China's economy grew, and this market had the potential to be utilised by British companies looking to export goods and services. Not all of China's market remained accessible; China has infrastructure weaknesses and significant regional income inequality, both urban-rural and coastal-inland inequalities (Kanbur and Zhang 1999). These problems meant that only a relatively small proportion of China's population were realistic consumers of UK exports: in the early 2000s, Breslin (2004) estimated this market to be around 150 million people. This is lower than some people perceive China's market to be, though this is still a significant market. Perhaps more importantly though, this market was expected to grow as the Chinese economy grew.

In addition to these challenges, the nature of the Chinese market meant that British companies often needed government assistance if they were to be successful. China had a different language, a different business culture and different laws and regulations that British businesses, particularly small and medium-sized enterprises, often found difficult to navigate. The Chinese state also had considerable control over the Chinese economy so close political relations were necessary for good economic relations – otherwise contracts might go to companies from more friendly countries. Many have argued that the difficulties for British companies justify the government in assisting private companies. For example, Lord Powell argued that China "is a market in which foreign companies, including British companies, need a great deal of help – help from government institutions, help from bodies like ours, the Business Council" (Foreign Affairs Select Committee 2000: para 127). These

arguments fit with New Labour's approach of using the state to help businesses to grow (Grant 2008).

In the late 1990s and 2000s a number of British agencies were expanded to assist businesses seeking to export to China. The China-Britain Business Council was set-up in 1991 (initially called the China-Britain trade group), and took part in trade delegations and hosting political leaders (CBBC website). The British Chamber of Commerce in China expanded significantly in the late 1990s, growing from a membership of 42 in 1993 to a membership of 245 in 2000 (Foreign Affairs Select Committee 2000: para 134). British Trade International (which became UK Trade and Investment) continued to operate in four different Chinese locations, and diplomatic posts were used to promote commercial links.

At the same time as action in the UK game, in the international game, China's decision to join the World Trade Organisation led to trade barriers being reduced and China's trade with the rest of the world substantially increasing. There is a large literature explaining the reasons why China decided to join the WTO (eg Lai 2001; Kim 2002; Liang 2002; Feng 2006; Breslin 2007: ch3). China were concerned about the future direction of the WTO: they would rather be in the organisation so that they could influence it, plus it might become harder to join at a later date (Breslin 2007: 93). Perhaps most importantly, China wanted to ensure they would continue to have access to export markets in the West, particularly the United States.

China's accession into the WTO happened after considerable international negotiation, in particular with the United States and the EU. Wei Liang (2002: 683) described the negotiation as "a complex intertwining of bilateral and multilateral negotiations". The US and China were in negotiation for decades, finally resulting in a deal that continued China's opening up to the world. The UK was represented by the EU, which agreed a bilateral deal with the Chinese in May 2000 (Liang 2002: 711). The UK –one of the most powerful countries in the EU – supported China's entry into the WTO based upon it "fulfilling trade-related and economic objectives", arguing that human rights did not form part of the WTO accession process (UK Parliament 2001). This made the UK a strong supporter of China's entry.

China's WTO accession had a significant impact upon China's economic relations with the rest of the world. It also had an impact upon China's domestic game: China modified more than 2,300 national laws and 190,000 local laws and regulations in order to comply with the accession agreement (Wang 2011). Trade barriers were rapidly cut – for example all tariffs on information technology products were eliminated; the services sector was opened to international competition; and the average tariff on industrial products was reduced from 24.6% to 9.4% by 2005 (Pan 2015: 744). This market opening led to a substantially increase in trade with the rest of the world. From 2001 to 2008, China's total imports and exports increased from \$510 billion to \$2.5 trillion, representing a five-fold increase in seven years (Pan 2015: 745). The UK's imports from China rose from £5 billion to £30.6 billion in the period 2000-2010 (House of Commons Library 2012).

The opening up of the Chinese economy had a number of important political impacts. From a Chinese perspective, trade liberalisation was controversial – particularly with those working in industries that were at risk from external competition – though popular opinion of the WTO in China later improved with continued economic growth (Wang 2011). From a Western perspective, the high volume of imports from China provided consumers with cheap goods, though also led to outsourcing of low-skill jobs (Ijiri et al 2010). The lowering of trade barriers also increased Western investment into China in order to manufacture goods to export to the rest of the world. China's WTO accession also led to China achieving a trade surplus and building-up its foreign exchange reserves.

### ***3.3.3 EU-China Trade Disputes***

The EU has competency over trade policy so it is unsurprising that the EU plays a vital role in trade relations between the UK and China. As will be discussed in chapter five, there were disagreements on trade both between the EU and China and within the EU that affects UK-China trade relations. There were two particularly newsworthy disputes that require attention here. The first is the so-called 'bra wars' and the second is the arms embargo. The significance of both of these disputes

highlight the importance of trade during this period, and the importance of the EU game.

Trade between China and the EU was the focus of public attention in the summer of 2005 during what the media dubbed the 'bra wars'. A dispute over European quotas in the clothing and textile industry meant that 75 million garments were blocked at European ports unable to be introduced into European markets (Comino 2007; Heron 2007). The blockade threatened the interests of three main groups: the Chinese producers, who could not sell the garments they had made; European clothes sellers, who had ordered the clothes and wanted to sell them; and European consumers, who would have to pay higher prices if the cheap, Chinese goods were prevented from entering the European market. In the end, the EU Trade Commissioner Peter Mandelson negotiated a deal with the Chinese that allowed the garments to be sold, however they were deducted from the 2006 quotas. The height that this dispute got to and the volumes of clothes involved demonstrates the importance of trade to EU-China relations.

The second major dispute in the mid-2000s between the EU and China arose around the arms embargo. The embargo had been in place since 1989 after the Tiananmen Square Massacre, during the same time that the US introduced an arms embargo (Tang 2005). China had lobbied for the lifting of the embargo since 1997, but it only became controversial again in 2003 when some EU leaders, including France and Germany, wanted to review it (Archick et al 2005; Portela 2010: 105). Numerous arguments were made within the EU for why the embargo should be lifted, particularly around the perceived ineffectiveness of the embargo, the progress that China had made in human rights and the commercial benefit that it would bring to the EU.

The embargo was a difficult decision for the UK, as the economic benefits of exporting arms weighed against pressure from other countries, especially the US, to maintain it. In 2003 and 2004, the UK government publicly said that it was "considering its position", and therefore did not give a firm position on the lifting of the embargo (House of Commons 2003; 2004). When the UK finally gave a position, it was a compromise position, saying that if the embargo was overturned there would be a stronger EU arms export control regime (Archick et al 2005).



The reason why the EU did not lift the embargo was pressure from other countries, particularly the US, Japan and Russia (Casarini 2007). Vennesson (2007) argues that “from October 2003 to March 2005, the prospect of lifting the [EU’s] arms embargo on China grew into a diplomatic crisis”. Washington objected very strongly to the suggestion of lifting the arms embargo partly because it would give the wrong impression to the Chinese government but mainly because of the improved capability it would give the Chinese military (Tang 2005: 319). Had the embargo been lifted, China would have had access to advance military technologies that it did not have access to, on weapons such as air-to-air missiles, torpedoes and sonar equipment (Van der Putten 2007).

Both the bra wars incident and the arms embargo dispute demonstrate the importance of the EU level to UK-China relations. The UK government were not directly involved with either incident, although they did express an opinion that carried weight and the EU Trade Commissioner between 2004 and 2008 – Peter Mandelson – was British, as was his successor, Catherine Ashton. These incidents also show that EU-China relations does not happen in a vacuum, but takes place in the context of wider global politics, and the arms embargo dispute highlights the influence of the US.

### **3.3.4 Comprehensive Strategic Partnership**

Going down a level from regional to bilateral, the UK and China developed a range of partnerships during the pre-crisis period. After the 1998 comprehensive partnership, Tony Blair visited China in 2003, which focused primarily on trade, saying that “the possibilities for Britain and its trade relationship with China are absolutely immense” (*Guardian* 2003, 21<sup>st</sup> July; BBC News 2003, 22<sup>nd</sup> July). Blair expected China to become the world’s largest economy within twenty to thirty years, and therefore wanted British business to engage more strongly with China. Chinese Premier Wen Jiabao visited the UK in May 2004, where a “comprehensive strategic partnership” was agreed to “intensify co-operation in broad areas of trade and investment” (China-UK Joint Statement 2004). Blair visited China for the final time as

Prime Minister in September 2005, and the two countries agreed to a “strategic dialogue mechanism” (Chinese Embassy website).

This strategic partnership ensured cooperation on issues where the UK and China had a mutual interest. It is certainly not unique in international relations as many countries have strategic partnerships or similar. The issues they engaged on had some importance but were never the most important issue for the UK. It is interesting to note that during ten years of Tony Blair being Prime Minister, he only visited China three times, in 1998, 2003 and 2005 (in addition to the Hong Kong handover ceremony in 1997, but then he stayed in Hong Kong). The lack of great significance in the partnership can be explained by the low level of interdependence that the two countries had. As China grew and the interdependence increased, a partnership with China became a more significant issue politically.

### **3.3.5 Prime Minister Brown**

After ten years as Prime Minister, Tony Blair stepped down in 2007 and made way for Gordon Brown. Brown's legacy as Prime Minister is centred on his response to the global economic crisis (Seldon and Lodge 2011), although there was a period between Brown becoming Prime Minister and the global economic crisis hitting. Although trade was still the primary focus in this period, finance was gradually becoming a more important issue. In 2007, the Financial Services Authority approved the Bank of China's application to open a UK subsidiary (Bank of China website). This allowed the Bank of China – one of China's “big four” banks (Berger et al 2009) – to open UK branches, which it has since done in the City of London, China Town, Birmingham, Manchester and Glasgow. The Bank of China's UK subsidiary was an important moment in the growing Chinese influence in the City of London. In addition, in July 2007 China invested \$3 billion into Barclay's Bank, which became the first major Chinese investment into the UK (American Enterprise Institute).

Gordon Brown made his first visit to China as UK prime minister in January 2008 (BBC News 2008, 18<sup>th</sup> January). Brown's main focus was economic issues, saying in

his autobiography that his visit was made “to cement the economic partnership with China” (Brown 2017: 242). Brown and Chinese premier Wen Jiabao agreed to increase trade by 50% by 2010, which Brown hoped would increase Britain’s exports to China particularly in financial services (*Telegraph* 2008, 18<sup>th</sup> January; *Guardian* 2008, 17<sup>th</sup> January). Brown also wanted one hundred Chinese firms investing in Britain by 2010 in order to create jobs for British workers, and the London Stock Exchange announced that it was setting-up an office in Beijing in order to encourage Chinese companies to list in London.

In May 2008, the Dalai Lama visited the UK and met with UK Prime Minister Gordon Brown in Lambeth Palace, discussing human rights and Tibet (BBC News 2008, 24<sup>th</sup> May; *Guardian* 2008, 22<sup>nd</sup> May). This was the first time a Prime Minister had met with the Dalai Lama since Blair’s 1999 meeting. China criticised the meeting more strongly than in 1999, arguing that it interfered with Chinese internal affairs and that it “hurt the feelings of the Chinese people”. Later in 2008, the UK recognised Chinese sovereignty over Tibet for the first time (*Telegraph* 2008, 5<sup>th</sup> November), although there was no obvious praise or reward from China for doing so.

Later in 2008, the UK and China had two major disagreements, both relating to human rights in Africa. The first was over China’s support for the Sudanese government in the War in Darfur, after China’s role in oil exploration (Large 2009; Bassil 2013). Although British foreign secretary Margaret Beckett had in May 2007 praised China for playing a “positive role” in Sudan (*Financial Times* 2007, 18<sup>th</sup> May), the BBC’s Panorama programme uncovered in 2008 that China had provided military assistance to the Sudanese government in breach of a UN arms embargo (BBC News 2008, 13<sup>th</sup> July). The second disagreement was over China’s backing of Robert Mugabe in Zimbabwe, also supplying the country with weapons despite human rights abuses (*Guardian* 2008, 18<sup>th</sup> April; 2008, 11<sup>th</sup> July; BBC News 2008, 18<sup>th</sup> January). Both issues resulted in public disagreements between the two countries.

The UK and China were seen together during the 2008 Summer Olympics closing ceremony in Beijing, including an Olympic flag transfer to symbolise the preparation for the 2012 London Olympics (*Telegraph* 2008, 24<sup>th</sup> August; *Independent* 2008, 26<sup>th</sup>

August). Gordon Brown visited the games and attended the closing ceremony, though he did not attend the opening ceremony despite an expectation in China that he would (BBC News 2008, 10<sup>th</sup> April). Despite Brown's (2017: 245) expectation of a difficult trip diplomatically due to his Dalai Lama meeting earlier that year, the Olympic handover and Brown's second China visit passed smoothly. The Summer Olympics occurred at the beginning of the global economic crisis of 2008-9, and therefore ends the second stage.

### **3.4 Stage 3: Response to Global Economic Crisis (2008-2012)**

The global financial crisis of 2007 and the subsequent global economic crisis of 2008-9 had a profound impact upon the global economy. Both the UK and China were affected and both took measures to stimulate their economies. In the UK, the financial crisis started in September 2007 with the bank run on Northern Rock, the first bank run in the UK since 1866 (Shin 2009), and the economy went into recession (ONS). The UK saw a change in direction in national economic policy, moving towards a surge in public sector borrowing and unconventional monetary policy (Hodson and Mabbett 2009). The UK's imports from China decreased temporarily as a result of the economic crisis.

China's experience of the financial and economic crises was different, though the impact remained substantial. Before the crises, China had an economic strategy that relied on producing and exporting low-end goods (Overholt 2010: 23-24). This strategy is associated with currency manipulation and large imbalances with the United States that have been cited as a major cause of the global financial crisis (eg French et al 2009; Obstfeld and Rogoff 2009; Ferguson and Schularick 2009; Helleiner 2011; Mees 2012). After the crisis, the model changed more towards an investment and consumption model, since the 'Go Out' policy was stepped up and consumer spending was promoted to a greater extent (Overholt 2010: 25; Yueh 2012). The Chinese government also enacted a RMB 4 trillion (US\$568 billion) fiscal stimulus package that supported the Chinese economy and averted potential social unrest (Overholt 2010: 28).

The significant changes to both the British economy and the Chinese economy represented a major turning point in UK-China economic relations. The flow of low-end goods from China to the UK did continue but was no longer the central political issue, replaced by Chinese investment into the UK, which began to increase. In the other direction, UK exports to China increased due to China's increased consumption and the growing middle-class in China. For these reasons, the focus of the relationship shifts from trade towards a combination of issues, including investment and finance, as will be explored in chapters six and seven.

In addition to the structural changes, the global financial and economic crises led to cooperation between the UK and China, particularly over financial matters. During China Premier Wen Jiabao's visit to the UK in January 2009, the two countries agreed a Joint Statement that aimed to work together to improve the "regulation, transparency, and integrity of financial markets" and promote "open markets for investments" (Joint Statement 2009). The cooperation on financial issues continued into the G20 London Summit in April 2009, in which China played a key role. The *Economist* (2009, 31<sup>st</sup> March) declared that China took "centre stage" at the G20 Summit, assuming an "increasingly self-confident tone when speaking to the rest of the world". Chinese President Hu met Gordon Brown the day before the summit and agreed the objectives of stabilising international markets, restraining protectionism and promoting necessary reforms of the international financial system (Permanent Mission of China to the UN, 2009 press release).

Coinciding with the financial crisis on the international stage was the Lisbon Treaty, which changed EU structures and entered into force in December 2009. The treaty's purpose was "to make the EU more democratic, more efficient and better able to address global problems, such as climate change, with one voice" (European Union website). The treaty altered the EU's foreign relations powers and decision making structure (Wouters et al 2008; Craig 2010; Piris 2010), for example creating the position of High Representative of the Union for Foreign Affairs and Security Policy. The treaty formally transferred the power to negotiate investment treaties from nation states to the European Union, though this did not happen as quickly as the treaty intended (Meunier 2014c), as is discussed in chapter six.

### **3.4.1 Prime Minister Cameron**

David Cameron became UK Prime Minister in May 2010, leading a Conservative-Liberal Democrat coalition. One of Cameron's major decisions was to implement austerity to reduce the government deficit (Lee 2011), which the government argued was "unavoidable" and necessary to "secure economic stability" (HM Treasury 2010: 5). One of the features of cutting government spending was that it took demand out of the economy and reduced reliance on the public sector, making the UK more reliant on other sources of demand, such as consumer spending, investment and exports. Chancellor George Osborne saw China as an economic opportunity, and tried to enhance economic cooperation between the UK and China. In his memoirs, David Cameron (2019: 158) argues that "the advantages of a deeper connection [with China] were undeniable".

In November 2010, just six months into his premiership, Cameron led a delegation to China with four other cabinet ministers and forty-three business leaders (BBC News 2010, 9<sup>th</sup> November; *Daily Mail* 2010, 10<sup>th</sup> November). The primary focus of the visit was trade and many contracts were signed, including a £750m Rolls-Royce deal. Overall though, the total value of the deals was relatively small, certainly when compared with President Xi's October 2015 visit to the UK. Mark Odell later argued that Cameron's visit had left him "almost empty-handed" and that his decision to "lecture the Chinese on the need to adopt multi-party democracy and improve human rights...had not gone down well" (*Financial Times* 2015a, 12<sup>th</sup> March). Cameron (2019: 159) agreed that his comments "weren't exactly welcome".

The exchange of delegations continued into 2011, with two visits to the UK from senior Chinese politicians. In January 2011, the UK had a visit from Chinese Vice-Premier Li Keqiang (who became China's Premier in March 2013). Li brought a large delegation from China including fifty government officials and a hundred business leaders for a four-day visit, during which he met the Prime Minister and other politicians (*China Daily* 2011, 11<sup>th</sup> January; *Guardian* 2010, 20<sup>th</sup> January). A modest £2.6 billion of deals were signed in total, and it was announced that two giant pandas would be sent from China to Edinburgh Zoo. Li's visit was followed five months later

by a visit from Premier Wen to London. Again, this trip was primarily economic, underlined by Wen's visit to the Shanghai Automotive-owned MG Rover plant in Longbridge for the launch of the MG6 Magnate Car (*Guardian* 2011, 24<sup>th</sup> June). The focus on economic deals with large delegations makes this stage different from the 1997-2008 period, where delegation-to-delegation meetings were not as frequent.

The post-economic crisis financial cooperation between the UK and China continued into early 2012 in investment and finance. HBSC became the first bank to issue bonds in renminbi in London (BBC News 2012, 18<sup>th</sup> April). They first attempted to raise a billion yuan with a three-year bond. This was a very significant moment for the city of London because it symbolised the opening up of the Chinese currency. While a yuan bond had been issued in Dubai previously, this was the first internationally recognised yuan bond from outside China or Hong Kong.

During the end of this period, there was an increase in Chinese investment in UK. Notable investments include Emerald Energy in August 2009, Apax Finance in February 2010 and Weetabix in May 2012 (American Enterprise Institute). This illustrates the different ways in which the UK and Chinese economies changed as a result of the economic crisis. The impact of stepping up the 'Go Out' policy was that investments into UK companies increased. The UK also became more reliant on China for investment, due to its domestic economic problems. China's greater assertiveness in international affairs is shown by greater voice at the G20 in responding to the economic crisis. This stage ran until 2012, when China initiated a freeze after David Cameron met with the Dalai Lama.

### **3.5 Stage 4: The Freeze (2012-2013)**

Stage four is the freeze, which marked an end to the productive diplomatic relations that had occurred since 1997. On 14<sup>th</sup> May 2012, UK Prime Minister David Cameron and Deputy-Prime Minister Nick Clegg met with the Dalai Lama privately in St Paul's Cathedral (BBC News 2012, 16<sup>th</sup> May). The Dalai Lama was met as a religious figure, just as he was when he met Tony Blair and Gordon Brown when they were serving Prime Ministers. However, Beijing responded much more angrily to this Dalai

Lama meeting than the previous two. The UK ambassador to China, Sebastian Wood, was summoned to China's foreign ministry and the Chinese foreign ministry announced that the UK had "hurt Chinese feelings" and interfered with domestic Chinese politics. The Chinese government later explained how it thought the row was entirely the British government's fault and that it was up to Britain to repair the relationship (*China Daily* 2012, 14<sup>th</sup> June).

The angry response from Beijing was followed by a diplomatic freeze between the UK and China, with several high profile meetings being cancelled. Chairman of the National People's Congress Standing Committee Wu Bangguo's visit was cancelled shortly after the Dalai Lama meeting took place (BBC News 2012, 14<sup>th</sup> June). Then when UK minister for trade and investment Lord Green visited China, the Chinese sent a junior minister to address the gathering then left quickly afterwards. When Foreign Office Minister Jeremy Browne visited Beijing, the Chinese ministry of foreign affairs refused to meet with him.

Trade and investment continued to increase during the freeze, however the reduction of open diplomatic contact meant that it is likely that trade and investment did not rise as quickly as it otherwise would have done. Stage four demonstrates the power that China had developed in world politics, or at least the perception of it (see previous chapter), and how China use economic flows to send a message on political issues like they have done with other countries (Lee and Meunier 2015). David Cameron (2019: 493) says that he was told by the FCO that "the Chinese would pretend to be cross about this for a couple of months, but it would blow over". The FCO was wrong on that, and the freeze changed the position of the UK towards China, with less focus on human rights and putting greater effort into impressing the Chinese in order to compete for investment.

### **3.6 Stage 5: The UK Competes for Chinese Investment (2013-2015)**

#### ***3.6.1 Rebuilding the Relationship with China***



The freeze lasted around eighteen months, only ending when the UK position on China changed. The government and Whitehall officials came to the view that ending the freeze was the only way to secure Chinese investment (*Financial Times* 2015a, 12<sup>th</sup> March; Interview with government minister 2018). The German government's courting of China meant that if the UK did not give in then China would choose to focus on relations with Germany instead of the UK (Kundnani 2015). Moreover, investment was badly needed, as the UK economy was still recovering from recession and a number of long-term infrastructure projects needed funding, including HS2 and a new energy plant. The Chinese investment would be a straightforward way to boost the UK economy.

2013 was also an important year because the Chinese president changed. Hu Jintao's ten years came to an end and was replaced by Xi Jinping. Ferdinand (2016: 941) argues that Hu "was extremely risk averse and largely preoccupied with maintaining domestic economic growth". The change to Xi was significant for China because of a change of direction. Xi was more focused on foreign policy: one of Xi's first actions was launching the Belt and Road Initiative (known then as 'One Belt, One Road') and Xi has demonstrated greater assertiveness in international affairs (Economy 2014). This was a good moment for the UK to re-set its relationship with China.

Cameron did this by going on a charm offensive. He publicly praised Chinese investment in a May 2013 interview with *Time Magazine* (2013, 23<sup>rd</sup> May). Cameron said:

I said to the Chinese Investment Corporation the other day, 'I'm not embarrassed that you own 10% of our biggest water company, or a big chunk of Heathrow airport. I'm proud. I think it's absolutely great. We want to be the destination for Chinese investment; tell the other Chinese investors, "Come to London; spend your money."' Of course if ever there were national security concerns, there are ways to raise those.

This quotation shows Cameron's desire for China to end the freeze and invest in the UK. In contrast to the earlier years of his premiership, he makes no mention of

human rights or democracy. The only danger of Chinese investment is if it affects security concerns; Cameron sees no danger in growing Chinese investment in the UK.

*Table 1 - Post Freeze Bilateral Visits*

<b>Date</b>	<b>Visitor</b>
October 2013	George Osborne
December 2013	David Cameron
June 2014	Li Keqiang
September 2015	George Osborne
October 2015	Xi Jinping

Cameron's reach out to China seemed to have an effect and the freeze ended during 2013, as the visits begin again after October 2013 as shown in table 1 above. UK Chancellor George Osborne made the first post-freeze in October 2013, promoting the UK as a destination for investment (CNBC 2013, 14<sup>th</sup> October) and announcing new scheme that allowed investors in London to apply for licences to invest renminbi directly into China, up to an overall quota of RMB 80 billion (Osborne 2013, 15<sup>th</sup> October). This was an early step in promoting renminbi use in the City of London, as will be discussed in chapter seven. Osborne made no mention of human rights whatsoever, even when asked directly. Chinese Deputy Finance Minister Zhu Guangyao seemed to suggest that the trip was a reward for Britain remaining silent on human rights and Tibet (BBC News 2013, 15<sup>th</sup> October):

“Frankly speaking, Prime Minister Cameron's meeting with [the] Dalai Lama harmed the Chinese-British relations. After joint efforts, the China-UK relationship has improved recently”

Osborne's visit was followed by a visit by David Cameron to China seven weeks later, then a return visit by Premier Li visited the UK in June 2014. Cameron, joined by six ministers and 120 business leaders, promised “a partnership for growth and reform” and met political leaders and investors (Prime Minister's Office 2013, 1<sup>st</sup>

December). Despite heavy criticism of the UK in the Chinese media, the visit resulted in £5.6 billion of trade and investment deals, which was much higher than Cameron's 2010 visit (BBC News 2013, 3<sup>rd</sup> November). Premier Li visited the UK in June 2014, seeking closer cooperation between the two countries (Li 2014, 16<sup>th</sup> June). Li's visit resulted in £14 billion worth of deals being announced, including a stake in the nuclear plant at Hinkley Point and an encouragement to bid for high-speed rail contracts (*Guardian* 2014, 17<sup>th</sup> June; BBC News 2014, 17<sup>th</sup> June). Once again, Cameron and Osborne never mentioned human rights, instead leaving the issue to Deputy Prime Minister Nick Clegg.

The reluctance to even mention human rights can also be seen in the UK's reaction to the 2014 Hong Kong protests. After fifteen years of relative stability in Hong Kong politics, the Chinese decided that Hong Kong's system of elections would change to give Beijing a greater say over candidate selection (Yuen and Cheng 2015). This was seen as an attack on Hong Kong democracy and a breach of the 1984 Joint Declaration. In September and October 2014, tens of thousands of protesters marched throughout the city carrying umbrellas, an event widely covered in the global media (CNBC 2014, 28<sup>th</sup> September; BBC News 2014, 11<sup>th</sup> December; Wang 2015).

Despite the historical significance of Hong Kong to the UK and that the UK was a signatory to the Joint Declaration, little was said by the UK government to challenge the Chinese government. David Cameron said at Prime Minister's Questions in October 2014 that he attached great importance to the Joint Declaration and that the UK should stand up for freedom in Hong Kong, however he did not refer directly to the Chinese (House of Commons 2014, 15<sup>th</sup> October). Even Cameron's indirect statement led to the Chinese retaliating by blocking the BBC website (China Digital Times 2014, 15<sup>th</sup> October). China prevented the Foreign Affairs Select Committee from travelling to Hong Kong in the preparing of a report into the Hong Kong democracy protests, something Cameron criticised (*Guardian* 2014, 1<sup>st</sup> December). Although David Cameron later raised the issues with candidate screening directly with President Xi, this was done privately and few details about the conversations have been made public (Hong Kong Free Press 2015, 23<sup>rd</sup> October).

The UK's refusal to publicly criticise China for human rights seems to have enabled greater economic cooperation. In October 2014, the Treasury hired three banks to issue renminbi bond sales in London, becoming the first Western country to do so (*Telegraph* 2014, 9<sup>th</sup> October). The bonds were issued in order to diversify the UK's public reserves, but also to symbolise London's position as the centre of global finance. The financial cooperation continued when the UK announced it was joining the AIIB in March 2015, becoming the first Western country to apply to become a prospective founding member (HM Treasury 2015). The AIIB supports finance for infrastructure projects across Asia with the intention of improving transport, energy, telecommunications, agriculture and urban development in the continent. The UK's membership gave it power over the governance of the organisation, as well as winning favour with Beijing for future investment. The United States signalled its dislike of the UK's decision saying they were "wary about a trend towards constant accommodation of China, which is not the best way to engage a rising power" (*Guardian* 2015, 13<sup>th</sup> March). Privately, David Cameron (2019: 587) was told that the US disliked the plan because "they felt it would enhance China's power in the region".

In September 2015, further announcements were made on strengthening financial relations during a George Osborne visit to China. It was announced that the People's Bank of China, China's central bank, would start to issue short-term debt in London (*Telegraph* 2015, 21<sup>st</sup> September). This was another major step towards renminbi use in London, as will be discussed in chapter seven. The September 2015 visit was also used to prepare for Xi's visit a month later, with Osborne setting a target to increase UK exports to China from £25 billion to £30 billion, and wanted China to become the UK's second largest trading partner by 2025 (BBC News 2015, 23<sup>rd</sup> September).

### **3.6.2 Xi's 2015 State Visit**

The pinnacle of the fifth stage was President Xi's visit to the UK in October 2015. During a busy visit, Xi met the Prime Minister and other ministers before having a state banquet with the Queen (*Guardian* 2015, 23<sup>rd</sup> October; BBC News 2015, 23<sup>rd</sup>

October). Xi addressed both houses of Parliament, saying that the UK and China were increasingly interdependent and that he hoped the UK and China could take their bilateral relations to new heights (CCTV News 2015, 21<sup>st</sup> October). It was reported that £30 billion worth of business deals were agreed during the visit, which Cameron said would create 3,900 jobs in the UK (Bloomberg 2015, 20<sup>th</sup> October; *Independent* 2015, 20<sup>th</sup> October; *People's Daily* 2015, 21<sup>st</sup> October). The biggest deal that was announced was China General Nuclear Power Corporation's £6 billion investment in the Hinkley Point nuclear plant, alongside the French firm EDF Energy (BBC News 2015, 21<sup>st</sup> October).

Similarly to the rest of this stage, the UK government avoided the topic of human rights publicly during the trip. The Chinese ambassador to the UK, Liu Xiaoming, said before the visit that Xi was not coming to the UK to debate human rights (BBC News 2015, 18<sup>th</sup> October). David Cameron did not publicly criticise China for its human rights record. Labour leader Jeremy Corbyn was given a one-on-one meeting with President Xi to raise human rights privately, after threatening to raise them publicly at the state banquet (*Independent* 2015, 20<sup>th</sup> October). Human rights were raised publicly by protesters, including from Amnesty International (2015), and the Dalai Lama (*The Diplomat* 2015, 19<sup>th</sup> October). The most public criticism of China's human rights came from the BBC's political editor Laura Kuenssberg, whose question on human rights to Xi was widely reported and praised by the British media (eg Huffington Post 2015, 21<sup>st</sup> October; *Spectator* 2015, 21<sup>st</sup> October; *Daily Mail* 2015, 21<sup>st</sup> October; *Metro* 2015, 22<sup>nd</sup> October).

This final stage shows how powerful China had become in the global political economy. The UK is a major global power, yet still put considerable effort into impressing the Chinese government to win investment. Human rights were ignored by government officials almost completely, and instead the Chinese government were praised for the way in which they took millions of people out of poverty. The UK was forced to compete with other countries to ensure that it received Chinese investment and financial cooperation. However, financial and investment relations seem to have been strengthened because of the UK's compliance.

### **3.7 Conclusion**

This chapter has outlined the key issues that have occurred between the UK and China in the period 1997-2015. It has argued that different issues and different levels are more important at different stages during the period this thesis studies. The first stage was the Hong Kong handover in 1997, which ended over 150 years of British rule in Hong Kong and moved relations onto other issues. In the second stage, the focus was on trade, during which China joined the WTO and increased its international trade significantly. The third stage was the response to the global economic crisis, when both countries' economies changed particularly the Chinese economic model. The fourth stage was the freeze, when China's power was demonstrated by shutting out the UK diplomatically after Cameron met with the Dalai Lama. During the fifth and final stage, the UK was welcoming and accommodating of China, which resulted in economic benefits.

This brief overview of the key events provides a groundwork for the next four chapters of this thesis on human rights and democracy, trade, investment and finance. Each of these issues is important to UK-China economic relations and each can be seen in this chapter. This chapter has argued that different issues are important at different times, with trade relevant throughout the period, investment becoming relevant after the economic crisis, finance only being relevant for the last few years of the period and human rights reducing in importance as time went on. The following four chapters deal with each issue in detail, involving more empirical evidence than has been possible in this summary chapter. The next chapter deals with human rights and democracy.

# **Chapter 4: Human Rights and Democracy**

## **4.1 Introduction**

This chapter is the first of four empirical chapters, each dealing with an important issue in UK-China economic relations. These four chapters present the research that has been conducted and explores each of the four issues in detail. In doing so, these chapters aim to ‘flesh out’ the bones that were the previous two chapters – chapters that covered the theoretical model and an outline of the time period respectively. The empirical chapters cover human rights, trade, investment and finance. The thesis starts with human rights in order to provide political context for the economic flows discussed in later chapters.

Human rights and democracy have been the primary non-economic tension between the UK and China in recent years. As this chapter will show, China’s lack of liberal democracy and controversial human rights record have caused considerable unease amongst British policymakers and NGOs about the UK’s dealings with China. The UK is not unique in this respect, and similar concerns have also been felt in other Western countries, in the EU and to some extent in global governance organisations. There has been a debate over the best way to contain China, with human rights NGOs demanding public criticism by Western leaders (Amnesty 2015; Interview with China Director of HRW), but recent political leaders avoiding human rights criticism to focus on economic deals. As time has gone on and the Chinese economy has grown, the focus on human rights has reduced.

This chapter considers the nature of UK-China human rights relations and how these relations evolved in the period 1997-2015. The next section explores the differences between the UK and Chinese conceptions of human rights and the differences between them, before describing Chinese human rights violations as seen by the FCO. The following five sections are structured around the four-level game. The third section of this chapter explains the UK game, arguing that political culture and NGOs put pressure on politicians to be seen to be acting on human rights, but these

pressures are less significant than economic pressures. The fourth section is the Chinese game, which outlines the Chinese view on sovereignty. China's economic growth, exaggerated by its imagined power, has allowed it to be more assertive and demand other countries do not criticise its human rights record.

The following two chapters discuss the EU and global governance games. These are relevant because the FCO (2007: 45) says: "the UK is committed to supporting the UN, the EU and other international institutions to bring about positive change". Both have dialogues and raise human rights issues, though IOs are more effective because they have greater legitimacy and avoid 'race to the bottom' problems. The seventh section covers the bilateral game, including bilateral human rights dialogue, support for specific projects, such as training of judges, and high-level engagement. These have made small improvements on specific issues, but have certainly not transformed human rights in China. Overall, China's growth – and therefore reduced sensitivity under Keohane and Nye's (2012) model – led to a race to the bottom in which UK political leaders felt they had to avoid human rights criticism to win investment deals. The UK's small impact that it had before the financial crisis disappeared as economic engagement with China increased.

## **4.2 Human Rights and Alleged Chinese Violations**

*"All human being are born free and equal in dignity and rights"*

Universal Declaration of Human Rights, Article 1

Human rights are "moral entitlements possessed by all simply by virtue of their humanity" (Tasioulas 2007: 2). They are considered to be universal and inalienable, applying to every human being regardless of which country they live in. There is significant debate among philosophers about how human rights should be understood, or where they come from (eg Donnelly 1982; Freeman 1994; Shestack 1998; Liao and Etinson 2012). This section aims to briefly sketch out the different conceptions of human rights in the West and in China, before describing some of China's alleged human rights violations. This helps understand why the UK objects to China's human rights record.



### ***4.2.1 UK Conceptions of Human Rights***

Rights in the UK have evolved over a long period. Ultimately, the UK understanding of human rights – and indeed, Western philosophy in general – is grounded on a combination of Ancient Greek philosophy (Whitehead 1957: 63; Shestack 1998: 206) and Judeo-Christian values (Ishay 2008: 19; Griffith-Jones and Hill 2015; Andrew 2015). Historically, the political system of each of the UK's constituent countries has been based on the monarchy, although common law and the concept of parliament have developed gradually (Goldsworthy 2010; Hudson 2014). The English Civil War and Glorious Revolution established the concept of Parliamentary Sovereignty, which still applies today. Rights are afforded by Parliament, with the House of Commons being elected by the public (albeit the franchise having broadened considerably).

Individual liberty has been a main part of UK rights, and have historically been more likely to be defined in negative terms. Both the Magna Carter and the Bill of Rights give negative rights, protecting individuals from certain acts of government. The emphasis on individual liberty continued during the enlightenment (Zafirovski 2010). John Locke (1689; 1690), who Weatherley (1999: 13) argues is thought to have laid the foundations for human rights, believed that “life, liberty and property” were natural rights, and that for a government to be legitimate it should protect those rights (Griffith 1997; Schouls 1992). The emphasis on liberal rights was protecting the individual against the power of the state. These rights were universal, applying to every person.

Ideas about economic rights, or positive rights, came much later in the UK. The right to a free primary education did not exist until 1891 (West 2000). Social welfare started with the National Insurance Act 1911, which gave workers an insurance system to protect against illness and unemployment (Gilbert 1965). In 1948, free healthcare to all was made available through a National Health Service, effectively ensuring that British people had a right to healthcare (Rivett 1998). It is interesting

that in the UK the political rights come before the economic rights, whereas in China the economic rights come first.

The UK is uncommon in having a political system that has evolved gradually over hundreds of years (Crick 2004), which has created “a political culture of moderation” (Almond and Verba 1989: 368). Nairn (1964) calls this an “incomplete revolution” as opposed to a full revolution such as the French had. The English have human rights roots in Magna Carta in 1215 and The English Bill of Rights in 1689 (Turner 2003: 1-2; Lock 1989). The legacy of these documents, and the way the British political system has developed, has led to liberty being entrenched into British politics both through its institutions, such as Parliament, and also through norms.

British politicians often appeal to history in support of the importance of liberty or human rights. Tony Blair (2006) talked about “ancient British liberty”. Gordon Brown (2007, 25<sup>th</sup> October) said that liberty had “central importance as a founding value of our country”. David Cameron (2015) said on the 800<sup>th</sup> anniversary of Magna Carta that the rule of law has been “sewn into the fabric of our nation”. These quotations show three prime ministers constructing a British identity based upon a narrative of history. As argued in chapter two, identities and norms are important in shaping preferences that determine how states interact.

#### ***4.2.2 China's Conception of Human Rights***

China's conception of human rights is different to the West. Rather than a worldview that is grounded in Greek philosophy and Judeo-Christian values, Chinese philosophy is a mixture of Confucianism and Marxism. Confucianism emphasised social harmony by suggesting that the interests of the state and the interests of a given individual can be brought into line (Peerenboom 1993: 39-40). Chinese intellectuals never sought to protect the individual against the state, but rather prioritised socioeconomic security (Perry 2008: 37). The emphasis was on economic rights, rather than negative rights.

European philosophy influenced China's thinking on rights since the mid-to-late nineteenth century (Weatherley 1999: 3). During the century of humiliation, Chinese academics received inspiration from the Western thinking on rights, particularly from Kant and Locke. Later, the CCP's thinking on rights was influenced by Marxism. After the 1949 Revolution, the ideology of Mao Zedong's government was influenced by Soviet Marxism, but many of his ideas were congruent with Chinese traditions (Perry 2008: 40). Mao's "iron rice bowl" gave cradle-to-grave welfare services for peasants (Leung 1994), whilst reforming land to satisfy the peasant mass base (Schwartz 1951: 189).

The post-Mao leadership have dismantled the iron rice bowl in order to facilitate economic growth, the underlying priority of the attainment of socioeconomic security remains. In 1984, Deng Xiaoping said he wanted the people's livelihood to reach an "economically comfortable standard" by 2000 (Perry 2008: 42). Jiang Zemin's "Great Leap West" has aimed to divert investment and capital towards the poorer, western regions of China and, like Deng, he said he wanted China to become an "economically comfortable society", this time by 2020 (Perry 2008:42). Xi Jinping (2012) acknowledged the importance of socioeconomic security in his first speech as president:

"Our people love life and expect better education, more stable jobs, better income, more reliable social security, medical care of a higher standard, more comfortable living conditions, and a more beautiful environment."

This demonstrates that the notion of positive rights remains in China today.

#### **4.2.3 Comparison**

This analysis of both UK and Chinese human rights evolution shows significant differences in how they conceive of human rights. The UK conception focuses more on rights in negative terms and on freedom from government; the Chinese conceive rights in positive terms and focus on socioeconomic rights. These two conceptions of rights can lead to different assessments being made of a country. Under the Chinese

conception of rights, it could reasonably be argued that rights in China are in good shape because of the improvements in living standards over the last forty years. Under a British or Western conception of rights, China does badly because of the low levels of individual political freedom and the government actions to prevent opposition. The different evolution on rights thinking in the UK and China is shown below in figure 4.

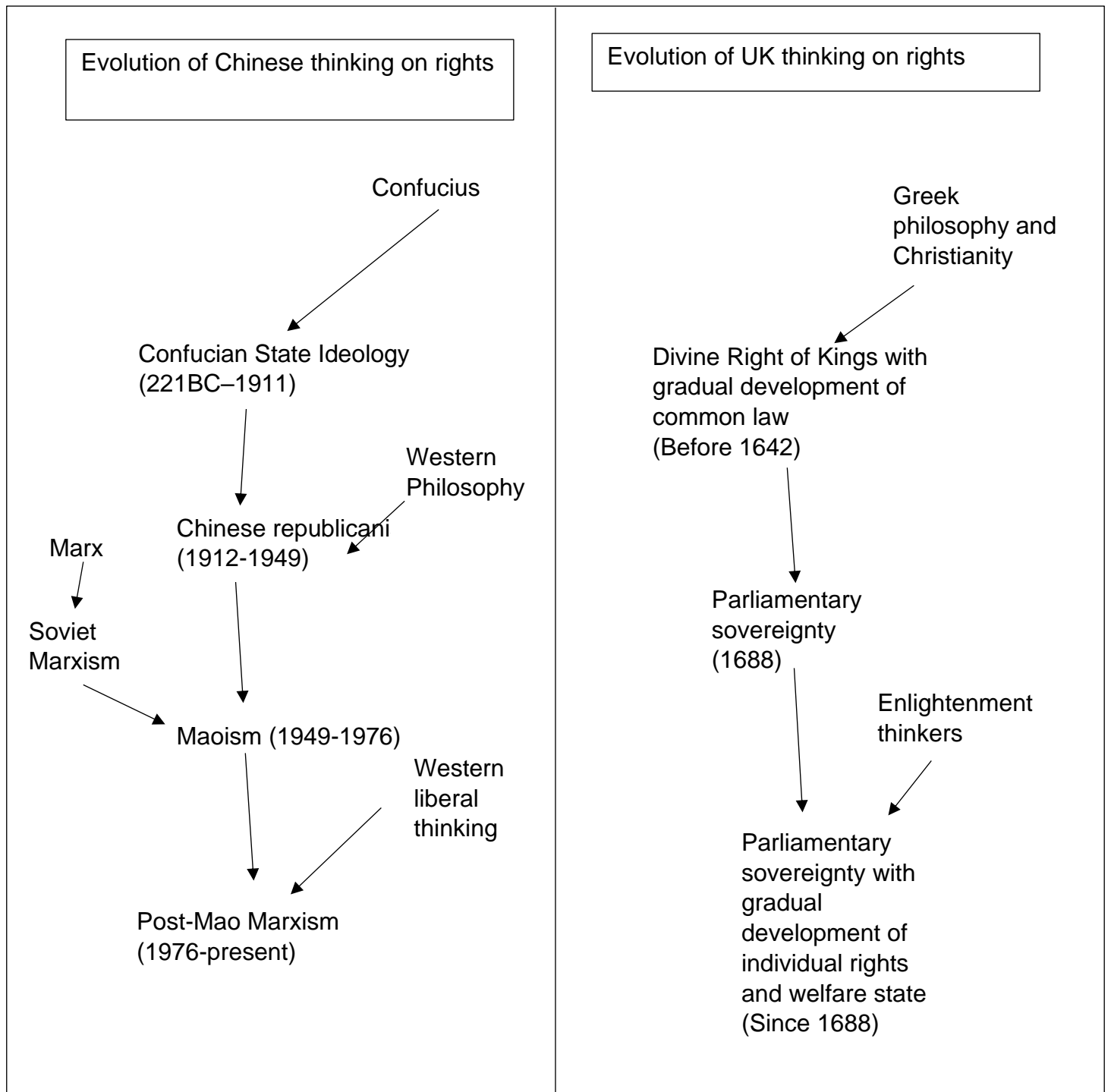


Figure 4 - Development of rights in the UK and China (Chinese part based on Weatherley 1999: 3).

Reconciling the difference in the conception of rights can be done in several ways. One argument is to appeal to cultural relativism, that human rights vary by culture. Jack Donnelly (1984: 401) says that, in its strongest form, cultural relativism “holds that culture is the principle source of the validity of a moral right or rule”. There are few rights that have universal application, and therefore a wide variation of morally acceptable sets of rights. The cultural relativist argument also alleges human rights imperialism, which occurs when human rights are used as a foreign policy tool in order for Western countries to pursue their own interests (eg Heuer and Schirmer 1998; Kinzer 2010). This line of argument is, unsurprisingly, an argument made by the Chinese government, as will be explained below.

The counter-argument is simply to say that human rights are universal and that China simply has a terrible human rights record. Micheline Ishay (2004: 16-17) argues that the Universal Declaration on Human Rights was not only signed by countries with different cultures but also drafted by a number of people representing “starkly contrasting cultural backgrounds and philosophies”, including a Chinese academic (see also Glendon 2001). Human rights therefore can be universal and should apply to everyone regardless of culture. This argument was used by Western governments including the UK (Cook 1995) and human rights NGOs (Interview with China Director of HRW).

#### ***4.2.4 Chinese Human Rights Violations***

Human rights in China have been criticised by the UK government, as well as by other Western governments and by NGOs. The FCO listed China as a “country of concern” in its Human Rights and Democracy Reports every year from starting in 2003 until the period ends in 2015. The US State Department (2014) has classified China as an “authoritarian state”. The EU said it had “serious concerns about the human rights situation in China” (European Union External Action 2009: 156). The NGO Freedom House (2016) has consistently rated China as “not free” and ranked its political rights as being among the worst in the world. Amnesty International and Human Rights Watch are very critical of China’s human rights record and produce reports explaining what they believe are the main issues (Interview with HRW China

Director 2017). This sub-section briefly describes some of the main human rights issues that the UK government and others have raised with China, including free speech, freedom of religious belief, the right to a fair trial, torture and the death penalty.

Free speech is severely restricted in China, and censorship exists on platforms ranging from newspapers, books, films, internet blogs and social media. The FCO (2003: 34) said: “The Chinese authorities put severe restrictions on the freedom of expression and information”. This view is supported by NGOs and activists. The NGO Reporters Without Borders (2016) ranked China as 176<sup>th</sup> out of 180 countries in their *World Press Freedom Index*. Journalists are forced to self-censor their reporting to avoid political confrontation (Tong 2009). Books and films are also censored (CNN 2013, 21<sup>st</sup> June; CBC News 2007, 20<sup>th</sup> January). The internet faces censorship through the “great firewall”, particularly views that encourage social mobilisation (Feng and Guo 2013; King et al 2013; Fu et al 2013). The FCO (2004: 55) have been particularly concerned about the blocking of the BBC in China.

Censorship in China means that people can be punished for advocating political reform. “Inciting subversion of state power” is a crime under China’s criminal code, punishable by detainment, imprisonment or Re-education through Labour camps (Chinese Human Rights Defenders 2008, 8<sup>th</sup> January; FCO 2011: 197). The 2010 Nobel Peace Prize was awarded to Liu Xiaobo for his “long and non-violent struggle for fundamental human rights in China” (Nobel Prize Committee 2010, 8<sup>th</sup> October). In 2009, Liu was given an eleven-year prison sentence for “inciting subversion of state power”, which was criticised by the FCO (2011: 194). This censorship also applies to academia (eg *New York Times* 2013, 10<sup>th</sup> December).

The right to a fair trial is strongly undermined by the lack of judicial independence. The FCO (2004: 52) have called upon China to provide “better protection of a defendant’s right to a fair and impartial trial”. Ting Gong (2004: 40) argues that “the most fundamental shortcoming of the Chinese legal system lies in the equivocal relationship between the Communist Party and the judicial authority”. Any judicial independence given in the constitution is undermined by the CCP’s leadership of the judiciary as major judges are members of the CCP, and typically nominated by the

party committee of the jurisdiction in which they serve (Gong 2004: 42). This allows pressure to be put upon judges to make decisions in line with the wishes of the CCP, particularly in politically sensitive or criminal cases (Freedom House 2016). At the same time, the accused are not always able to have adequate legal support, for example Amnesty International (2016) report that in July 2015 there was a crackdown on human rights lawyers, many of whom were defending people accused of inciting subversion of state power. This further undermines the rights of the accused.

In addition to not having a fair trial, the punishments and methods of extracting evidence used in court has been said to breach human rights. China carries out more executions than any other country in the world (Miao 2013), which the FCO (2012: 43) has campaigned against. The FCO (2011: 198) has also expressed concern about the “high risk of torture” faced by some detainees. The Chinese criminal justice system allegedly relies to a large extent upon confessions for convictions, giving the police an incentive to torture suspects (Amnesty International 2015). Interviews conducted by Amnesty International (2015: 22-23) suggest that the methods of torture used include beatings; deprivation of sleep, food or water; use of handcuffs or ankle fetters for extended periods; exposure to extreme conditions of heat or cold; and use of “tiger benches” and “hanging restraint chairs”. Torture is most likely to occur at basic level, in police stations and be disproportionately applied to the lowest socioeconomic group of the society (Wu and Beken 2010).

The FCO (2012: 142) have voiced concern about restrictions in the practice of religion. Officially, religion is more tolerated now than under Mao (Brown and Tierney 2009: 311), with now five religions – Buddhism, Taoism, Islam, Protestantism and Catholicism – accepted but subject to state controls (Potter 2003). Religious groups that are outside the state-sanctioned body have been subject to persecution, particularly Protestant house churches (Potter 2003: 334; Open Doors UK website). Religious freedom has been even worse for religions that are not included as part of the five sanctioned religions. In particular, the Falun Gong has been considered by the Chinese government to be a “heretical cult” and is banned and oppressed (Keith and Lin 2003). Various methods of persecution are used, including torture, and the Falun Dafa Information Center have confirmed the deaths of 3,800 people –



something they regard as genocide (Falun Dafa Information Center website). In addition, the Chinese government have also been accused of being complicit in killing tens of thousands of Falun Gong practitioners for the purpose of organ harvesting (Kilgour and Matas 2006; Gutmann 2014).

In addition, the FCO have raised human rights issues in specific regions of China, in Tibet and Xinjiang. The FCO (2004: 54) described Tibet as a “cause for concern. Tibet is often seen as a threat to the Chinese federal government primarily because of its disputed political status, and this has led to the Chinese central government cracking down on separatists and dissenters more harshly than in other parts of the country (Sautman and Dreyer 2006: 3). Amnesty International (1992) have expressed a wide range of human rights concerns about Tibet, including holding political prisoners without a fair trial, mistreatment of prisoners, use of torture and extra-judicial executions. This approach is not entirely unique to Tibet: Sophie Richardson (2017) argues that a similar approach has been used in Xinjiang. The FCO (2004: 54) have raised concerns about Xinjiang, including the concern that “China is using the war on terror to abuse the rights of the Uyghur community”.

This section has compared the UK and Chinese conception of human rights before outlining some of the human rights abuses that the FCO and others have shown concern about. These abuses include restrictions on free speech, the fairness of the criminal trial system, the use of the death penalty and torture, freedom of religion, and the specific issues with Tibet and Xinjiang. The following five sections focus on the five games in the four-level game. This applies the human rights issues discussed in this section to UK-China relations in the domestic situations, the bilateral relationship, the EU and in global governance. The next section looks at the UK domestic game and how human rights in China are approached in the UK political system.

### **4.3 UK Game**

#### ***4.3.1 Sources of Domestic Human Rights Pressure***

As argued above, the UK has a long history of human rights now embedded in its culture. As a result of this, every government since 1997 has explicitly claimed that ethical considerations are a core part of foreign policy. Robin Cook (1997) claimed that “foreign policy must have an ethical dimension”, and that “the Labour Government will put human rights at the heart of our foreign policy. Margaret Becket said “The promotion of human rights and fundamental freedoms is a moral imperative” (FCO 2006: 3). Gordon Brown (2007, 24th June) spoke of his “moral compass”. David Miliband (2008) talked about “our moral impulse”. William Hague (2011) argued he was pursuing “foreign policy with a conscience” that “will always have support for human rights and poverty reduction”. Philip Hammond said that “improving human rights is a core function of the Foreign Office and is the responsibility of every British diplomat around the world” (Foreign Office Press Release 2016). These statements all appeal to morality to argue that human rights should be an important consideration in foreign policy.

In the political establishment more generally, human rights groups also exist within political parties and in parliament. Parliamentary reports into China that have made recommendations on human rights, including reports by the Foreign Affairs Select Committee (1998; 2000; 2014) and the House of Lords European Union Committee (2010). The All-Party Parliamentary Group on Human Rights (eg 2016) have attempted to raise awareness of human rights issues in China. Both main political parties have human rights campaigns – the Labour Campaign for Human Rights and the Conservative Party Human Rights Commission respectively. The Conservative Party Human Rights Commission (2006; 2016) is more internationally focused and has published reports recommending a greater human rights focus in China.

In addition to the moral arguments, human rights are promoted by an NGO policy community that campaigns on prioritising human rights. In particular, Amnesty International and Human Rights Watch are large worldwide organisations that promote human rights. A large part of what they do is research-based, including through Amnesty’s annual “the state of the world’s human rights” reports (Amnesty International website) and Human Rights Watch’s annual “World Report” (Human Rights Watch website). In addition to publishing issue-specific reports, including on

China, both NGOs have close links to government and the civil service. They give evidence directly to parliamentary committees about human rights in China, some of which is cited in parliamentary reports (eg House of Lords 2010). They also directly advise government ministers and civil servants on policy (Interview with China Director of HRW 2017). The FCO (2005: 17) say “we consult NGOs and academics before and after our bilateral dialogues with China”. By providing information directly to government, these NGOs are acting as insider pressure groups, which confers advantages such as being more likely to be trusted by government (Grant 2004).

A ‘policy community’ analysis (Rhodes 2006), as explained in chapter two, is useful to theorise the relationship between NGOs and the UK government on human rights and China. There are a limited number of actors involved in human rights policy towards China, consisting of small teams of civil servants on China and on human rights, the two main human rights NGOs and a handful of academics. They have frequent and high-quality engagement between them, and all share a belief in human rights. They are powerful insofar as human rights is an important for the UK government. Human rights decline as an issue as time goes on, but that has little to do with changes to the UK game, but rather is influenced by the China game as is argued below.

Something that is less effective in influencing policy is grassroots campaigns. There are many China-focused campaign groups in the UK, including the two large NGOs and issue-specific campaign groups such as Free Tibet. All these groups have organised protests during Chinese visits to the UK. During President Xi’s state visit to the UK in October 2015, Amnesty International and Free Tibet organised prominent protests on human rights issues (Amnesty International UK press release, 15<sup>th</sup> October 2015; Free Tibet press release, 20<sup>th</sup> October 2015). These protests – which have occurred during every Chinese visit for decades – have not changed public policy towards a greater human rights orientation. Instead they fit with Srnicek and Williams’s (2015: 12) concept of “folk politics”, defined as “a collective and historically constructed political common sense that has become out of joint with the actual mechanisms of power”. The 2015 protests were also undermined by pro-China protests, which the BBC’s *Newsnight* (2015, 20<sup>th</sup> October) reported were organised by the Chinese embassy.

### **4.3.2 FCO Human Rights Promotion**

As a result of the domestic pressure put on the government to consider human rights in their foreign policy, the FCO have produced an annual Human Rights and Democracy Report since 2003 (Foreign Office website: Human Rights and Democracy Reports). These reports are typically several hundred pages long, and increase priority issues and “countries of concern”. China was one of four countries to be included as a “country of concern” in every report from 2003 until the thesis period ends in 2015 (the others were Iraq, Burma and Zimbabwe). The reports described the UK government’s concerns with China including what abuses they believe to have taken place. For example, the 2003 report has six pages on China, and opens:

“We have concerns about a wide range of human rights issues including: freedom of religious belief; the extensive use of the death penalty; the use of torture; arbitrary detention, including the practice of re-education through labour; freedom of expression; freedom of association; the deprivation of religious and cultural rights in Tibet and Xinjiang; prison conditions and the treatment of prisoners; psychiatric abuse; treatment of Falun Gong supporters; and aspects of the implementation of the one child policy” (FCO 2003: 33).

Similar statements are made in the first paragraph of each of the Human Rights and Democracy reports throughout the period.

The reports also comment on the evolution of human rights in China throughout the period, mentioning both positive and negative developments. Examples of positive developments include meetings between the Chinese government and representatives of the Dalai Lama (FCO 2006: 43) and ratification of the International Covenant on the Rights of Disabled People (FCO 2008: 127). On the other hand, negative developments include “worsening treatment of activists and greater limitations on freedom of expression” (FCO 2010: 158). The explanation of developments helps the FCO prioritise which countries to focus its human rights

efforts onto. China's constant appearance on the "countries of concern" list is linked to the lack of improvement in human rights.

#### ***4.3.4 The Limits to Human Rights Promotion***

Domestic pressures exist on the government to take human rights into account when negotiating with China. However, the existing literature on UK foreign policy has generally been sceptical of government claims to be pursuing an ethical foreign policy. Victoria Honeyman (2017: 42) argues all Prime Ministers have adopted a pragmatic style of foreign policy making and any changes were "largely presentational". Gaskarth (2013) argues, based upon elite interviews, that ministers believe the constraints and complexities of foreign policy making means that ethics can only play a marginal role. Payne (2006) and Wheeler and Dunne (2005) argue that although ethics played a role, such as in international development, it largely remained unchanged from previous periods. The Blair government's claims of an ethical foreign policy were also undermined by the failures of the Iraq War (Chandler 2003; Bulley 2010).

There are three reasons why human rights have only played a relatively minor role in relations with China. The first is that the interests of human rights NGOs are less powerful than the privileged position of business, as neo-pluralism predicts (Lindblom 1977). In the UK, the financial sector is particularly powerful (Ingham 1984; Green 2018), and this is important when financial relations with China become more relevant after the financial crisis, as is explained in chapter seven. The second reason is that there is very little that the UK can do to make a significant difference to human rights in China, given China's size (Breslin 2004: 415-416). The third reason is that the general public generally speaking are more concerned with their material interests than human rights abroad. Although some people in the UK vote altruistically, generally people vote to improve their standard of living (Johnston et al 2000).

Using Putnam's (1988: 437) concept of win-sets, it can be inferred that human rights were not an essential part of the UK negotiating position. The weakness of domestic

human rights pressures meant that human rights groups were not able to veto UK policy towards China in a way that the financial sector could, as will be explored in chapter seven. Since human rights promotion was not an essential part of the UK win-set, the Chinese government were able to push the UK into avoiding the issue of human rights in the final years of the period. This explains the inconsistency with which successive British governments prioritised the issue of human rights.

Further evidence of this can be shown through an analysis of the manifestos of the Labour and Conservative Parties between 1997 and 2015. Figure 5 below shows a content analysis to count the number of mentions of four selected terms: “human rights” in an international context, which excludes mentions of the Human Rights Act; “China”; “prosperity”; and “economic growth”. It is reasonable to assume that if an issue is more important politically then it would be mentioned more in manifestos. The results support the view of international human rights being less of a political issue than living standards, as the term “prosperity” is mentioned more than “human rights” in an international context in nine out of ten of the manifestos and almost three times more frequently in total. China is rarely mentioned, only being mentioned more than once in two out of the ten manifestos. Of the eleven mentions in total, just two were about human rights (in the 2010 Conservative manifesto and the 2015 Labour manifesto). Two mentions in eighteen years of general election manifestos is hardly a major issue.

Party	Year	Mentions of "human rights" in international context	Mentions of "China"	Mentions of "prosperity"	Mentions of "economic growth"
labour	1997	4	0	4	4
Conservative	1997	0	1	9	0
labour	2001	4	0	13	6
Conservative	2001	0	0	4	0
labour	2005	2	0	19	3
Conservative	2005	0	1	2	0
labour	2010	3	1	14	5
Conservative	2010	4	3	6	5
labour	2015	8	1	9	3
Conservative	2015	3	4	7	3
	Average	2.8	1.1	8.7	2.9

Figure 5 - Mentions of selected terms in manifestos 1997-2015

It is argued below in the bilateral game section that a little progress was made on human rights issues. However, human rights have never been the most important issue, and after the financial crisis reduced even further in importance. Economic issues were more important, as will be argued in the following three chapters. Where the UK did have a bigger human rights impact is through international organisations, where the problem of competition does not exist and legitimacy is less of a problem.

#### ***4.3.5 Changing Norms on Human Rights and China***

It is worth mentioning how Western norms on China's human rights development have changed in the period. As discussed in the introduction, when one compared the 1990s to the 2010s, the West seems to have lost some confidence in the superiority of liberal values and in its geopolitical position vis-à-vis China. In the aftermath of the Cold War, some thought that liberal democracy was the end of ideological development (Fukuyama 1992). By the 2010s, the West was weary of its failures, such as the economic crisis, and increasingly viewed China as a threat. No topic in this thesis illustrates this more clearly than China's human rights development.

In the 1990s, the accepted norm was that China would liberalise politically as it liberalised economically. This Manchester school argument was used by Western politicians to justify liberal trade policies towards China, particularly in the context of WTO accession. In the US, this argument was used by President Bill Clinton to justify US support for China's WTO accession (Clinton 2000). In the UK, Foreign Secretary Robin Cook (2000) argued that "the integration of China into the world community... is the most powerful external factor likely to strengthen the rule of law and lead to an improvement in the human rights situation in China". The accepted norm was that more trade would push China in the direction of greater human rights.

During the Coalition in the 2010s, the top of government was not vocal in making a Manchester school argument. After the 2012 freeze, David Cameron and George Osborne did not criticise China on human rights. In September 2015, George



Osborne seemed to have given up on political liberalisation in China when he said “We raise human rights, but we do it in the context of talking about issues like economic development” (BBC News 2015, 23rd September). This is very different to Robin Cook’s arguments fifteen years previously.

David Cameron’s memoir is instructive because it explains how a former Prime Minister’s view on China changed. Cameron says that in 2010 he thought that the Chinese political system could not last in the face of economic liberalisation. However, his view on political liberalisation changed as time went on. Cameron (2019:159) writes:

“Surely this was now a consumer society in which people had increasing amounts of choice over their lives. How could the ruling party frustrate that when it came to politics?  
While my fundamental view hasn’t altered – change, in some form, will come – multiple visits to China have led me to a more nuanced view...China’s path to greater pluralism may be a very long one, with a different destination to our own.”

This idea of a ‘different destination’ is key to the norm shift – no longer is the conventional wisdom that China will become a liberal democracy. This goes back to the argument in the introduction that China is more likely to be perceived as a threat by the West.

This is the only part of this chapter where the thin constructivist element of the theoretical approach comes in. The ideational shift is a paradigm shift, which was discussed in chapter two. The norm change has not had a significant impact upon UK policy towards China however, since there is still strong economic engagement. Changes in UK-China economic relations are better explained using material reasons, particularly China’s economic growth, than ideational reasons.

## **4.4 China Game**

### ***4.4.1 Rights in China***

As argued earlier in this chapter, China has a different conception of human rights compared with the West. Whereas the West conceptualises human rights in individualistic and negative terms, in China human rights are conceptualised more in terms of group rights and in positive terms. The Chinese government have taken on the cultural and material relativity arguments to deflect criticism from Western governments and NGOs. China stated at the UN Commission on Human Rights in April 2003 that international concern over human rights in China was “unimportant, meaningless and irrelevant” (FCO 2003: 37). Chinese minister Liu Huaqiu told the UN World Conference on Human Rights in 1993:

*“The concept of human rights is a product of historical development. It is closely associated with specific social, political and economic conditions and the specific history, culture and values of a particular country.... Thus, one should not and cannot think of the human rights standard and model of certain countries as the only proper ones and demand all countries to comply with them”* (cited in Angle 2002: 1)

Similarly, Xi Jinping said:

“China attaches great importance to the protection of human rights. We combine the universal value of human rights with China’s reality, and we have found a path of human rights development suited to China’s national conditions” (UK Government: Joint Press Conference 2015)

These statements make cultural and material relativity arguments. Liu’s argument about “historical development” is relevant to the UK and China since each country’s politics has evolved separately over hundreds and thousands of years. Xi talks about “China’s reality”, and this includes its lower GDP per capita than Western countries – something that is particularly relevant if rights are defined in economic terms. In a 2018 speech, Xi argued that the CCP had always prioritised human development, and had been successful due to the significant improvements in standard of living (cited in *China Daily* 2018, 10<sup>th</sup> December).

Indeed, from a Chinese perspective, China actually has a rather positive record on human rights (eg *China Daily* 2005, 12<sup>th</sup> December). Due to the vast economic growth that has taken place, hundreds of million people have been taken out of extreme poverty, and standards of living have increased for every income level (World Bank data). In 2019, the Chinese government published a 'White Paper on human rights progress in China' which stated that in the seventy years since the founding of the PRC, "the people of China are living a happier life, the world is more prosperous, and human society is more diverse and colourful" (China Daily 2019, 23<sup>rd</sup> September: preamble). Health and education – two important factors under an economic understanding of human rights – have also improved significantly in China during the last forty years. These trends are seldom mentioned by Western human rights NGOs, who the Chinese government would argue have a strong Western-bias.

A further argument used by the Chinese government is the perceived hypocrisy of Western criticism of China's human rights record. This line of reasoning says that the United States, European countries and international institutions should not criticise China's human rights record when their own record on human rights is not without fault. Since 1998, China have produced an annual report entitled "The Human Rights Record of the United States" criticising a number of alleged US human rights abuses including the use of torture, poor race relations, gun violence and the abuse of prisoners during the Iraq War (eg State Council 2005). Similar charges of hypocrisy could be levelled against the UK, including on the Iraq War.

Finally, China have had success in convincing other states of the validity of its human rights approach. Ming Wan (2013: 124) argues: "China is not really isolated in the international community on the issue of human rights. In fact, the United States sometimes finds itself isolated." At the UN, China has done a good job at finding allies in countries from Asia, Africa and Latin America to combat Western human rights criticism. Chris Alden (2005: 153) finds that "African votes have been crucial to Beijing's multilateral diplomacy", including on human rights issues at the UN. Rather than isolating the Chinese government, which is what the West intended, human rights have become a much more contentious issue.

#### **4.4.2 Sovereignty and Non-Interference**

As well as having a different conception of rights, Chinese political leaders and academics put great emphasis on China's sovereignty. As argued in chapter two, the Chinese school of IR (to the extent that it can be defined) views the international system from a China-centric perspective, and asks questions based upon China's experience (Qin 2011). This includes noting that China has followed its own path to development, rather than following a Western model, and arguing that China – and, indeed, non-Western countries more generally – should be able to continue following their own development path (Xiao 2018). Part of this opposition to Western interference comes from the memory of China's 'century of humiliation' – discussed below – but it is also influenced by the prominence of realism in Chinese IR departments (Qin 2008), which views human rights criticism as a form of power politics.

The Chinese government also dislike foreign governments commenting on China's human rights record, which can be shown from statements given by Chinese leaders. Two of Mao Zedong's five principles of peaceful coexistence, which he agreed with India in 1954, were "mutual respect for each other's territorial integrity and sovereignty" and "mutual non-interference in each other's internal affairs" (United Nations 1958: 70). Deng Xiaoping said that "China will never allow other countries to interfere in its internal affairs" and, when negotiating over the future of Hong Kong, told Margaret Thatcher that the "sovereignty issue is not negotiable" (cited in Pan 2010: 230-231). In 2011, the Chinese government included state sovereignty and territorial integrity as part of its "core interests" (State Council 2011). Xi Jinping has continued this tradition, frequently telling foreign governments not to intervene in its foreign affairs (eg *Xinhua* 2016, 3<sup>rd</sup> September). Indeed, as *The Economist* (2014, 15<sup>th</sup> March) notes, "hardly a press briefing goes by at the foreign ministry in Beijing without a stern reminder of the importance China places on the principle of non-interference in other countries' internal affairs".

Sovereignty and human rights are not necessarily the same thing. It would be possible to for a country to breach China's sovereignty on an issue unrelated to

human rights. However, from the Chinese government's point of view, human rights criticism is always a breach of its sovereignty. For the purposes of this section, sovereignty is treated as core part of China's response to human rights criticism.

The Chinese government argue that its principles on sovereignty and non-interference are a product of its history. In this view, China and the West have different conceptions of sovereignty because of their different histories. The Western conception of sovereignty emerged out of the Peace of Westphalia in 1648, when an "attempt to check the preponderance of any one state" meant "the end of...pretensions to universal monarchy" (Bull 2012: 31). Thus for the West, sovereignty is ultimately about self-determination and is closely linked to the nation state. In contrast, Chinese ideas about sovereignty are linked to colonialism. As Pan (2010: 229) argues: "China's first encounter with the concept of sovereignty was in the nineteenth century when it was invaded by Western powers". The "unequal treaties" that China was forced to sign during its "century of humiliation" meant that China lost some of its territory, including Hong Kong. Thus, "the Chinese generally relate sovereignty to territorial integrity" (Pan 2010: 230).

For this reason, the Chinese government strongly enforce their sovereignty. As previously mentioned, China stated that the transfer of sovereignty in Hong Kong and Macau was non-negotiable. This includes their 'One China principle', which says that there is one China and that Taiwan is part of this (Wei 1999). It also includes Tibet, which China is determined to continue to exercise sovereignty over, despite many Tibetans desiring independence (Goldstein 1997). In all of these situations, the Chinese conception of sovereignty – in which the Chinese state has the right to maintain its historic territorial integrity and govern its territory independently – clashes with the Western belief in the right to self-determination (Goldstein 1997: ix). The Chinese government seems to believe that foreigners do not have the right to even comment on domestic issues.

In recent years, some have sought to question how absolute China's belief in sovereignty really is. Sow Keat Tok (2013) has argued that once China's sovereignty and the "One China principle" are accepted, there is room for negotiation on the specifics of what that precisely means. The "one country, two systems" approach

has allowed Hong Kong to develop different political structures and different values compared to mainland China; with Taiwan, the “One China with different interpretations” has allowed Taiwan to also develop different political structures and values, while coinciding with increased social, political and economic interactions between Beijing and Taipei (Tok 2013: 1-2). While China continues to claim sovereignty over Hong Kong and Taiwan, the way this was achieved was by negotiation. Similarly, with some recent international issues, China’s principle of sovereignty does not look absolute. China refused to explicitly criticise Russia’s annexation of Crimea, despite going against Ukraine’s sovereignty (*Economist* 15<sup>th</sup> March 2014). When China engages with Africa it claims to respect the sovereignty of African countries, but in reality interferes with the sovereignty of African countries by demanding diplomatic recognition and access to resources (Alden 2005; Brautigam 2009) – something the Chinese would not want other countries doing to them. Therefore, while China gets defensive about its own sovereignty, this belief in sovereignty is not always extended to other countries.

#### **4.4.3 Human Rights Criticism and Economic Flows**

China has aggressively defending its sovereignty in numerous ways, including through use of economic flows. Both internationally and domestically, China have sought to harm or marginalise groups and countries that they consider threaten either the ‘One-China’ policy or the Chinese government’s ability to govern domestically. Domestically, the Chinese government have cracked down on what they see as Tibetan separatists, which has been widely criticised by human rights groups (Hillman 2014). In foreign affairs, China does not give aid to, nor does China have relations with, Swaziland, which has maintained its relationship with Taiwan (Brautigam 2009: 2). After the Nobel Peace Prize was given to Chinese dissident Liu Xiaobo in 2010, China imposed an extra tariff on the salmon it imported from Norway, causing much of their fish to rot (*Independent* 2011, 5<sup>th</sup> October).

The link between political compliance and healthy economic relations with China can be shown through quantitative analysis. Andreas Fuchs and Nils-Hendrik Klann (2013) use a gravity model of exports to China from 159 partner countries to

illustrate that for the Hu Jintao era (2002-2012), there exists a statistically significant link between countries receiving the Dalai Lama at the highest levels of government and a drop in that country's exports to China, particularly in machinery and transport equipment. The impact, however, is temporary, as this 'Dalai Lama effect' disappears after two years. Lee and Meunier (2015) use a similar method to argue that the 'Dalai Lama effect' also applies to foreign direct investment. Using FDI data between China and various European countries, they show that there is a statistically significant drop in Chinese outward foreign direct investment into a country when the political leaders of that country meet with the Dalai Lama. This effect lasts for around six months, a shorter time period than the trade Dalai Lama effect.

Both of these papers show how China politicises economic flows in order to support nationalist objectives. These papers also show that China's assertiveness has become greater as time has gone on and China has become richer. Fuchs and Klann (2013) analyse data before Hu became the President of China in 2002 and find no evidence of the Dalai Lama effect; the effect is only seen from 2002 onwards. Similarly, the effect in foreign direct investment flows is only relevant since the financial crisis because the investment flows prior to the financial crisis were so low. This trend across time reflects the increased negotiating power that China has, which is strongly related to its increased wealth. This is relevant to the UK with the freeze after Cameron's 2012 meeting with the Dalai Lama.

This analysis helps build the four-level game by revealing China's preferences. As also argued in chapter two, the legitimacy of China's government comes partly from economic growth and partly from ideology, a large part of which is nationalism. Both of these sources form an important part of China's preferences in international negotiations. Neither of these preferences necessarily trumps the other and, as this section has demonstrated, China was willing to forgo potentially mutually beneficial economic deals in order to punish countries that are vocally critical of its human rights record or meet with the Dalai Lama. China does this to provide a disincentive to other countries and make them more likely to remain silent on human rights issues.

## **4.5 European Union Game**

### **4.5.1 The EU as a Channel for the UK**

Since its foundation, human rights has been part of the normative basis for the EU and predecessor organisations. The Treaty of Paris (1951) talks of safeguarding world peace. The Treaty on European Union (1992) sets out the EU's core principles as being "liberty, democracy, human rights and the rule of law". The Copenhagen Criteria, which sets out the criteria for new countries wanting to join the EU, includes the rule of law, human rights, democracy and respect for minorities. The Lisbon Treaty (2007: preamble (1)(a)) states that Europe's inheritance led to the development of "the universal values of the inviolable and inalienable rights of the human person, freedom, democracy, equality and the rule of law". Figure 6 below shows the EU's normative basis according to Ian Manners (2002).

Founding Principles	Tasks and Objectives	Stable Institutions	Fundamental Rights
<ul style="list-style-type: none"><li>• Liberty</li><li>• Democracy</li><li>• Respect for human rights</li><li>• Rule of law</li></ul>	<ul style="list-style-type: none"><li>• Social solidarity</li><li>• Anti-discrimination</li><li>• Sustainable development</li></ul>	<ul style="list-style-type: none"><li>• Guarantee of democracy</li><li>• Rule of law</li><li>• Human rights</li><li>• Protection of minorities</li></ul>	<ul style="list-style-type: none"><li>• Dignity</li><li>• Freedoms</li><li>• Equality</li><li>• Solidarity</li><li>• Citizenship</li><li>• Justice</li></ul>

*Figure 6 - the EU's normative basis (Manners 2002)*

The EU's human rights basis also applies to its foreign policy. The EU claims that "it actively promotes and defends [human rights] both within its borders and when engaging in relations with non-EU countries" (European Union External Action website). Indeed, the Treaty of Lisbon (2009: part 2) requires the EU to "uphold and promote its values and interests", including human rights. High Representative Catherine Ashton (2011) said that "we speak out and act against human rights violations wherever they occur". High Representative Federica Mogherini (2016) said "the European Union as a whole will continue to play a leading role in promoting a rules-based global order, with respect for human rights at its core".



Some have argued that Europe's values are important because they affect external policy. Ian Manners (2002) has suggested that the EU has "normative power", something he defined as "the ability to change the conception of normal". However, there are reasons to be sceptical of the EU's normative claims with regard to relations with China. Adrian Hyde-Price (2006; 2008) argues that the EU's human rights policies seem hypocritical and disingenuous when it pursues economic or strategic interests above human rights. Mikael Mattlin (2012) has described EU's normative power over China as being "dead on arrival", since pursuing a normative foreign policy against a major country like China is "an almost impossible task". It is argued below that the EU-China human rights dialogue is ineffective.

The ineffectiveness of the EU has not stopped successive UK governments claiming that it uses the EU as a channel through which to talk to China about human rights. In 1996, Jeremy Hanley told the House of Commons:

"We raise our concerns with the Chinese authorities regularly both nationally and as part of the European Union." (House of Commons 1996)

The FCO (2009: 68) say:

"The EU's Common Foreign and Security Policy (CFSP) is a significant instrument for the effective promotion of human rights and democracy around the world."

The FCO (2013: 132-133) later said:

"The UK Government works through the EU to pursue our international human rights policy objectives. The EU's status as the world's largest aid donor and major global economic actor affords it significant influence to promote respect for human rights across the globe. The UK Government considers that we should use the tools at the EU's disposal to promote human rights and democracy beyond the borders of its 28 member states."

This shows how the EU was part of the UK's stated human rights strategy as the UK claims that it has used its influence in the EU to promote human rights. This is a convenient answer to give when answering the human rights campaigners who want the UK to do more. By partially delegating the issue to EU level, the UK can respond to NGO concerns whilst avoiding direct responsibility – just as principle agent theory suggests (eg Nielson and Tierney 2003; Hawkins et al 2006). Delegating to the EU is undermined by the limited way in which the UK influences EU norms and the ineffectiveness of the EU.

#### ***4.5.2 EU-China Human Rights Dialogue***

The central way in which the EU attempts to influence Chinese human rights is through direct bilateral dialogue. This dialogue was started in 1995 and takes place twice a year, one under each EU presidency (Delegation of the European Union to China website). The dialogue has discussed a range of human rights issues, including political freedoms, the death penalty and specific cases of arbitrary arrest and detention. The dialogue takes place in parallel to member states' dialogue with China, including the UK's. The FCO (2007: 76) say that co-ordination between the different dialogues is attempted, as information learned in the UK-China human rights dialogue is shared with the EU.

The key question is whether the human rights dialogue was effective with regard to improving human rights in China. The EU seems to claim that it does, with their website stating:

“The dialogue, together with pressure from other international partners, has contributed to yield some concrete results (visits to China by the UN Commissioner for Human Rights, signing of the UN Covenant on Civil and Political Rights, signing and ratification of the UN Covenant on Social, Economic and Cultural Rights, release of prisoners, setting up of Commission co-operation projects etc.) but the EU has made it clear on several occasions that it wanted the dialogue to achieve more tangible improvements in the human rights situation on the ground. Nothing will demonstrate that non-

confrontational dialogue produces results more effectively than China's own concrete actions.” (European Union Action Service website)

This lengthy quotation from the EU website seems to suggest that the bilateral dialogue was successful, producing “some concrete results”. This also gives examples, although the only identifiable examples involve yet further delegation to other bodies.

Katrin Kinzelbach argues that the EU-China human rights dialogue is at best a waste of time and at worst actually harmful to human rights. Kinzelbach (2015: 197) argues that the dialogue was performed by junior Chinese government ministers and therefore “relegated and isolated human rights from higher-level political dialogue”. In addition, the quiet nature of confidential dialogue meant that China did not feel under pressure to change its practices, since there was no cost to them of taking little action. Kinzelbach (2015: 196) also argues that “A direct link between the EU–China Human Rights Dialogue and a positive human rights-related decision can credibly be established in only one case: the visit of the Special Rapporteur on Education to China in 2003.” This was pretty minor compared to the Chinese human rights abuses listed earlier in this chapter.

McMillan-Scott and Chen (2013) take a similar view:

“The EU-China human rights dialogue, established 14 years ago, has yielded no tangible results, serving instead as a fig leaf for European leaders' general reluctance to challenge China robustly on its human rights record.”

This makes the argument that the EU-China dialogue was only being used as a political convenience to answer questions about human rights and China. Being able to direct concerns about human rights in China to the bilateral dialogue isolates EU leaders from having to deal with this difficult issue. In this way, both the EU leadership and the Chinese leadership are isolated because of the deferral to the dialogue. EU leaders can be seen to be doing something, even if it is not effective.

With respect to UK-China relations, this shows that the EU was not an effective channel for UK human rights promotion in China. Whilst the UK government has suggested that the EU is one channel through which it can address China's human rights problems, this is undermined by two problems. First is the lack of significant influence that the UK has on the EU's values, much of which were set before the UK even joined the EU. Secondly, the EU is ineffectiveness at promoting human rights in China, with the dialogue producing no tangible results. These problems demonstrate the ineffectiveness of the channel. That is not to say that an obvious alternative exists, only that the EU is not effective for promoting human rights in China. The EU also has the problem of fragmenting its relations with China.

#### ***4.5.3 Incoherence of EU Approach***

As a House of Lords (2010: para 315) report notes, the EU-China relationship exists in parallel with Chinese relationships with member states, particularly the UK, France and Germany. This makes it less incoherent, because European countries may have different opinions, in addition to the different voices within each country and within the EU. It also means that, at regional level, the UK had to take into account what other European countries, particularly France and Germany, were doing. This is because different European countries are in a race for Chinese investment (which is discussed in more detail in chapter six), and this can mean compromising on other issues, such as human rights (Oxelheim and Ghauri 2008; Meunier 2014c). This has led to a race to the bottom, where human rights are not discussed at all in order for countries to protect their economic interests. The power shift has made European countries more vulnerable to Chinese government decisions, as those decisions have a bigger impact upon the European economy.

As time has gone on and China has become more powerful, the fragmenting of Europe has become more pronounced. One way of showing this is to compare the arms embargo dispute between 2003 and 2005 with the more recent issues surrounding Chinese investment. During the arms embargo dispute, the Chinese government did attempt to 'pick off' European countries, and initially succeeded in doing that with France and Germany (Archick et al 2005). However, pressure from

the US was more powerful and the embargo was not lifted (Casarini 2007). The Chinese strategy of dealing with individual countries to undermine the EU approach was evident then, although Chinese power was insufficient to achieve its objective in this case.

The more recent issues surrounding investment have worked better in China's favour, as China was successful in discouraging human rights criticism with the threat of removing investment. As discussed in chapter three, David Cameron's meeting with the Dalai Lama in 2012 resulted in a freeze in diplomatic relations which hindered the UK's ability to attract trade and investment. Germany and France had similar experiences in being frozen out of diplomatic relations. German Chancellor Angela Merkel met with the Dalai Lama in 2007, which led to a slowdown in relations until the following year including China cancelling a human rights dialogue meeting (Schnellbach and Man 2015). After the 2008 economic crisis, Merkel was less vocal in her criticism of China's human rights. Similarly, a 2008 meeting of French President Nicolas Sarkozy with the Dalai Lama led to China calling off an EU summit (*Guardian* 2008, 27<sup>th</sup> November). Germany, France and the UK were deterred from criticising human rights in China after this response.

Ultimately, this problem of an incoherent EU approach towards China is difficult to solve. Perhaps an obvious solution would be to strengthen EU foreign policy institutions at the expense of national governments to ensure a more unified policy. However this is made difficult because of the eurospecticism that opposed further European integration and eventually led to the UK's vote to leave the EU in 2016. The EU is not a country and cannot replace state's foreign policy. Furthermore, realistically any attempt to influence human rights in China would need the support from the US. For these reasons, a coherent EU approach towards China is unlikely and so the 'race to the bottom' problem that has occurred throughout the period is likely to continue for the foreseeable future.

#### **4.6 Global Governance**

In addition to the UK being able to channel human rights concerns through the EU, global governance institutions have also been used as a channel. The FCO (2009: 58) say: “We couple bilateral action with sustained activity across all the multilateral organisations”. The UK plays a major role in many of these organisations, and uses this influence to promote human rights, including in China. This section looks at four of the international institutions that the UK has used to promote human rights in China: the UN Human Rights Council; the ILO; the International Covenant on Economic, Social and Cultural Rights; and the International Covenant on Civil and Political Rights. The section then argues that global governance institutions have also had limited effectiveness in implementing change in China but that they are the best available channel for the UK government to use.

#### ***4.6.1 UN Human Rights Council***

One organisation that the UK uses to promote human rights is the UN Human Rights Council (UNHRC). The FCO (2012: 233) says that the UK “has been at the forefront of the work of the UN Human Rights Council”. The UNHRC was set-up in 2006 to promote human rights around the world, replacing the heavily-criticised Commission on Human Rights (UNA-UK 2014: 4). The UK was a member of the council for four terms, from 2006 to 2011 and from 2013 to 2019. One of the key ways in which the UK has strengthened the UNHRC is through its support for Universal Periodic Review (UPR) (UNA-UK 2014: 5). The UPR is a process whereby every UN member state is assessed on its human rights record every four years, primarily by three other countries, though other member states are allowed to ask questions publicly, which are responded to by the country being assessed.

During China’s UPR in November 2013, the UK asked questions about publication of data on the use of the death penalty, intimidation against individuals from civil society, the ability of diplomats and NGOs to access China and treatment of civil rights activists (UN Office of the High Commissioner for Human Rights website). The UK also formally recommended that China “Set out a clear legislative timetable for ratification of the [International Covenant on Civil and Political Rights]”. This is one

channel through which the UK can express its concerns about human rights to China.

#### **4.6.2 International Labour Organisation**

The International Labour Organisation (ILO) is another international institution that the UK uses to improve international human rights. The UK is a permanent titular member of the governing body of the ILO and, since 2012, the British trade unionist Guy Ryder has been the ILO's director-general (ILO website). Like with the UNHRC, the UK has worked both inside and with the ILO to improve human rights, such as on forced labour (FCO 2007: 132; 2012: 132). The UK is also a major financial contributor to the ILO, providing additional voluntary contributions (ILO website).

China has also been a member of the ILO since its formation. While China's relationship with the ILO was particularly weak after the CCP took power in 1949, it has since improved (Kent 1997). The UK has encouraged China to sign-up to more ILO conventions during human rights dialogues (FCO 2005: 41). The ILO is a potentially important institution for improving human rights in China because of the labour rights issues that are present there, for example they have continued to challenge trade unions (Chan 2014). Since 1997, China have ratified a number of conventions, which are shown in table 2 below.

*Table 2 - ILO Conventions currently in force that have been ratified by China 1997-2015 (ILO website)*

<b>ILO Convention</b>	<b>Date Ratified</b>
Maritime Labour Convention 2006	12 <sup>th</sup> November 2015
Occupational Health and Safety Convention 1981	25 <sup>th</sup> January 2007
Discrimination (Employment and Occupation) Convention, 1958	12 <sup>th</sup> January 2006
Labour Administration Convention, 1978	7 <sup>th</sup> March 2002
Safety and Health in Construction Convention, 1988	7 <sup>th</sup> March 2002

Minimum Age Convention, 1973	28 <sup>th</sup> April 1999
Employment Policy Convention, 1964	17 <sup>th</sup> December 1997

Some of these conventions have real impact in either strengthening or enhancing labour rights in China. For example, the minimum age convention, ratified by China in April 1999, sets 16 as the minimum age for admission to employment or work. However, the greatest impact of these conventions is the norms that can be diffused into China. Ann Kent (1997: 531-532) argues that China has shown “cognitive learning in respect to some basic labour standards”. From a constructivist point of view, the ILO helps labour rights norms diffuse into the Chinese state. In this way, the UK has contributed to improved labour standards in China through its work and support to the ILO.

#### ***4.6.3 International Covenant on Economic, Social and Cultural Rights***

The International Covenant on Economic, Social and Cultural Rights (ICESCR) builds upon the Charter of the United Nations and the Universal Declaration of Human Rights and, as its title suggests, it covers economic, social and cultural rights, such as labour rights, health and education. China ratified the ICESCR in March 2001. China’s ratification of this treaty was seen as a success of the UK’s diplomacy. In 1998, Foreign Office minister Derek Fatchett listed China’s recent signing of the treaty as one of the “tangible results of the human rights dialogue” (House of Commons 1998). In 2004, Foreign Office minister Bill Rammell listed China’s ratification of the treaty as one of the “encouraging developments since we began our human rights dialogue” (House of Commons 2004). These quotations show that the British government has tried to take some credit for China’s ratification of the treaty. There is at least a correlation between what the UK raised in bilateral meetings and what China did, even if a causation is difficult to prove.

The Economic and Social Council undertake reports to assess the compliance of countries that have ratified the treaty. China was assessed twice during the period, in 2005 and in 2014. The 2005 report listed twenty-eight “principle subjects of concern” on issues including migrants, transparency, gender inequality and health (Economic



and Social Council 2005). Perhaps the central issue that the committee identified was the need for justiciability in the economic, cultural and social rights (Choukroune 2005: 32). In 2012, the Economic and Social Council (2012: 3) made an assessment of the implementation of the 2005 report in which they state: “The main recommendations of the Committee, such as the formulation of a national human rights plan of action, have already been implemented”. The second report in 2014 made fifty-two “principle subjects of concern”, each with a recommendation (Economic and Social Council 2014). In this way, China’s ratification can be said to have made a difference to its human rights because of the detailed scrutiny that can be viewed publicly.

#### ***4.6.4 International Covenant on Civil and Political Rights***

The International Covenant on Civil and Political Rights (ICCPR) is an international treaty that covers issues relating to civil and political rights (UN Office of the High Commissioner for Human Rights website). These issues include the right of people to self-determination, right to not be tortured, the right to equality based on certain protected characteristics and the right to a fair trial. The covenant was adopted by the UN General Assembly and has been signed and ratified by the majority of countries. The UK ratified the ICCPR in 1976, and it has been in force ever since. China signed the ICCPR in 1998, but is still yet to ratify it.

China’s failure to ratify the ICCPR has been an issue in human rights dialogue between the UK and China. It was raised at human rights dialogue meetings (eg FCO 2004: 52), as well as by a range of ministers, including Foreign Secretary Jack Straw and Chancellor of the Exchequer Gordon Brown (FCO 2005: 41). It was also raised by Prime Minister Tony Blair during his 2005 visit to China (FCO 2006: 46). However, this pressure has so far been unsuccessful at achieving Chinese ratification, and the Chinese government have not set out a timetable for ratification.

#### ***4.6.5 The Effectiveness of Global Governance Institutions in Promoting Human Rights***

As argued in the introduction to this chapter, human rights in China are difficult to change quickly. Neither the bilateral nor EU human rights engagement with China has resulted in overwhelming improvements to human rights, nor have the four global governance institutions analysed in this section fundamentally transformed China. However they have made some improvements, and have had agenda setting power. China's ratification of ILO conventions has resulted in changes to China's labour rights. Alan Neal (2016: abstract) argues "there is clear evidence of influence from the international level upon the content and formulation of modern PRC labour law provisions". The UN Human Rights Council and the Economic and Social Council have raised many concerns about specific aspects of human rights in China that appear to have been broadly implemented by the Chinese government (Economic and Social Council 2012: 3).

The reason that this level is the most effective is that there are several advantages of IO engagement over bilateral or regional engagement with China on human rights issues. Firstly, the world is bigger than the EU or UK, and this size helps legitimise criticism of China's human rights record. It would not be unreasonable for the Chinese government to question whether a country of 1.4 billion people should be lectured to by a country of just 65 million or a regional union of around 500 million (World Bank data 2017). An IO representing countries that have a total population of over seven billion gives the criticism more legitimacy.

Secondly, and relatedly, IO engagement representing countries from around the world does not suffer quite as much from imperialism or Western-centrism compared with engagement from just the UK or EU. It is true that the philosophical foundations of most IOs are Western, and that Western countries have disproportionate influence in IOs relative to their population size. However, Western-centrism is less of a problem if China is criticised by an IO that almost every country is signed up to rather than by a Western country directly. The first UN Human Rights Council Periodic Review of China was facilitated by rapporteurs from Canada, India, and Nigeria, and the second had rapporteurs from Poland, Sierra Leone and the United Arab Emirates (UN Office of the High Commissioner for Human Rights website). This geographical diversity means the problem of Western-centrism is reduced.

Finally, engagement from IO avoids the issue of the 'race to the bottom'. As discussed above, individual countries have avoided the issue of human rights to find favour with the Chinese government to secure trade and investment deals. An international agency whose only objectives are human rights related does not have the tension between human rights and economic gains that an individual country may have. If the international community is acting with one voice, then China cannot set one country off against another. Through international organisations, the UK can raise human rights concerns indirectly with the Chinese government but without the vulnerability that is associated with public bilateral human rights criticism.

#### **4.7 Bilateral Game**

The clearest way in which the UK seeks to improve human rights and democracy in China is directly, through bilateral human rights dialogue, specific projects and high level engagement. Throughout the period, the UK government took the view that engagement with China was the best strategy to promote human rights in China. In 2003, the FCO (2003: 137) said they "believe that a policy of engagement rather than isolation remains the right approach to promote systemic reform and better human rights in China". In 2011 and 2012, the FCO (2011: 192; 2012: 137) described their approach to human rights in China as "one of constructive long-term engagement". FCO minister Bill Rammell told the House of Commons that "bluntly, [China] is a country that we have to engage with" (UK Parliament 2004). This strategy of direct engagement applies to human rights as much as any other chapter.

The 2012 FCO Human Rights and Democracy Report says that the bilateral approach consists of "three main pillars: high-level lobbying and engagement, the bilateral human rights dialogue and financial support to projects in-country" (FCO 2012: 137). These three pillars were in place for throughout the period, with a generally similar structure for human rights dialogue and support for specific projects. There was a change in high-level engagement, as previously argued in the last chapter, as there is no longer any public criticism of human rights whereas in the

late 1990s and early 2000s there was. This section discusses each of these three pillars in turn, relying mainly on FCO reports and interview data for information.

#### ***4.7.1 Bilateral Human Rights Dialogue***

Since 1997, the UK and China have maintained a human rights dialogue, during which a team from the FCO meets with a team from the Chinese Foreign Ministry to discuss human rights issues. This started off being twice a year (FCO 2003: 37) but has since reduced to being approximately annually. It has some parallels with the Economic and Financial Dialogue, also held approximately annually. One difference however, between the two dialogues is that the EFD is led by the UK Chancellor and Chinese Vice-Premier, whereas the Human Rights Dialogue was led initially by junior ministers (Interview 2017), but more recently has been conducted entirely by diplomats (Chinese Embassy press release 2016). The difference in seniority is likely because of the difference in expectations of progress made in the meetings, with the EFD more productive.

The Human Rights Dialogue is used to discuss various issues that arise between the UK and China. Unfortunately minutes are not published, unlike with the EFD, and there is a variability of the volume of information released about what was discussed at these meetings. FCO reports do allow an insight into the topics discussed, as do some answers to parliamentary questions (eg UK Parliament 2001; 2002). For example, the 9<sup>th</sup> dialogue in November 2002 discussed labour rights; new regulations on the use of evidence in administrative proceedings; the holding of village elections; torture; the death penalty; Xinjiang; and access to BBC World Service in China (FCO 2003: 38-40). The 13<sup>th</sup> dialogue in June 2005 discussed “ICCPR ratification, [Re-education Through Labour], the death penalty, torture, North Korean border crossers, religion, Tibet, Xinjiang, Falun Gong and cooperation with UN mechanisms” (FCO 2005: 44). The 20<sup>th</sup> dialogue in January 2012 discussed “detainee rights, migrant rights, capital punishment, freedom of expression, freedom of religion, China’s plans for ratification of the ICCPR [and] ethnic minority rights” (FCO 2012: 137). These lists tell us that similar issues are raised throughout the period.

Specific cases of concern have also been brought up at the dialogue. For instance, in the June 2005 dialogue meeting, forty-nine “cases of concern” were brought up, with the FCO disappointed that the Chinese Foreign Ministry only offered explanations for thirteen of them (FCO 2006: 48). These cases include cases involving British citizens and also cases where the FCO believe the person accused of a crime was treated harshly or denied proper legal rights. The UK government cannot intervene in the legal processes of a foreign country, but it can ask for an explanation of specific cases.

#### ***4.7.2 Support for Specific Projects***

The UK has supported a range of specific projects in China that aimed to improve human rights and democracy. The Human Rights and Democracy Reports 2003-2015 mention various projects that have occurred between the UK and China. The FCO (2005: 44-45) listed several new projects for 2005-6:

”We are supporting a range of human rights projects in China to promote change. New projects for 2005–06 include: promoting judicial justice by reforming criminal trial procedure; reforming the death penalty review system; standardising the death penalty through sentencing guidelines; police and human rights; enhancing human rights in prisons; research into corporate social responsibility (CSR) best practice in China; and CSR capacity building for government trainers. Other human rights projects continue from last year. These are strengthening the defence in death penalty cases; reforming re-education through labour; preventing police misconduct; running an empirical study of the criminal justice system in China; developing and piloting a labour court; and promoting media transparency.”

There are a wide range of projects included here on issues ranging from criminal trial processes to prisons to police conduct to media regulation. The UK has well-defined and well established practices and processes for each of these issues. The hope

was that, by sharing this practice and assisting China in reforming areas relevant to human rights, China's processes would become closer to UK best practice.

A particularly important area that has been subject to multiple projects between the UK and China is the criminal trial process. In 2005, as part of a two-year scheme, academics from the UK and China advised on how to improve the legal process for criminal trials on issues such as providing protection for defence lawyers; limiting the role of judges in collecting evidence outside the court; and improving the quality of verdicts (FCO 2006: 22). The scheme resulted in a series of proposals for how to improve criminal trial procedures to the National People's Congress. After that project, another project offered training for Chinese judges (FCO 2008: 94). In later years, a delegation of UK Supreme Court judges (FCO 2011: 197) and the Head of International Family Justice for England and Wales (FCO 2014: 89) visited China to engage with judges and government officials. These projects are useful for China to improve its criminal trial processes which improves the human rights of a fair trial.

Prison reform is another important area and one which projects have led to demonstrable results. In 2010, the FCO (2010: 21) worked with academics at the UK-based International Centre for Prison Studies to "bring prison management practices in China towards international human rights standards". This resulted in changes being made to prison law and prison construction standards in China, which the UK viewed as being improvements to human rights. That is not to say that prisons in China are admired by human rights groups. On the contrary, Chinese prisons have been criticised by NGOs for poor conditions and forced labour (eg Human Rights Watch 2013). However, this does show that UK engagement has made a difference, even if it was a small one.

#### ***4.7.3 High-Level Engagement***

The final way in which the UK have bilaterally raised human rights with China is through high-level engagement. This occurs when human rights are raised as a topic of discussion between government ministers of the two countries. During the period of New Labour, high-level engagement on human rights was publicised and

ministers were publicly critical of human rights. The FCO's Human Rights and Democracy Reports openly talk about the meetings that junior ministers had with Chinese officials and some of the topics that they discussed (FCO 2004: 50-51; 2006: 15). Answers to written parliamentary questions also reveal human rights conversations between ministers (eg UK Parliament 1999; 2003). These generally showed that the views being expressed publicly by the government were also being put directly to the Chinese government at ministerial level as well as in the Human Rights Dialogue. In 1998, FCO minister Derek Fatchett told the House of Commons: "We raise human rights issues with China in every meeting" (UK Parliament 1998). This formed part of the policy of constructive engagement.

In November 2010, David Cameron took a more direct approach to promoting human rights in democracy in China. At Beijing University, Cameron publicly advocated multi-party democracy and the rule of law, suggesting that they made the government better and the country stronger (*The Telegraph* 2010, 10<sup>th</sup> November). This was much more direct than either Tony Blair or Gordon Brown had been and was more wide reaching than a specific human rights issue. Cameron's approach was not particularly constructive because the Chinese government were dismissive of it and so the impact was minimal. It was an unsuccessful visit in economic terms as well, certainly so compared with the later bilateral visits. The November 2010 visit resulted in £2 billion worth of deals, compared with £40 billion in October 2015 (BBC News 2010, 9<sup>th</sup> November; UK Government 2015).

After the freeze, David Cameron did not mention human rights publicly. As explained in the last chapter, Cameron was careful to avoid the issue in order to win over the Chinese government. Even when there were the 2014 protests in Hong Kong, Cameron did not publicly raise the issue, despite the UK's obvious role in Hong Kong. However, whilst not raising human rights issues publicly, he insisted that these issues were raised privately. Indeed in Xi's 2015 visit, Cameron made the argument that:

"The stronger our economic trading, business and other partnerships,  
the stronger our relationship and the more able we are to have the

necessary and frank discussions about other issues [including human rights].” (UK Government 2015)

In other words, Cameron argues that actually a strong economic relationship means that the human rights engagement can be stronger. This is not borne out by the evidence provided earlier in this chapter, which is that raising human rights publicly or meeting the Dalai Lama leads to weaker economic ties with China.

#### ***4.7.4 Effectiveness of Bilateral Engagement on Human Rights***

The effectiveness of the bilateral engagement on human rights is difficult to establish, as it is impossible to know what would have happened without it. This is particularly true given that many of the issues that the UK government were raising with the Chinese government were already being raised by other countries or IOs. Furthermore, the projects that the UK supported usually involved working with domestic groups in China, who were already trying to influence Chinese domestic politics on human rights issues. Disentangling the impact of the work of the UK government from the domestic sources of political and social change within China is not easy and probably beyond the scope of this thesis. Several conclusions can be drawn however.

At the outset, no-one seriously expected the human rights engagement to produce revolutionary changes in China. After all, China is a very large country with a long history. Changing that political culture takes a long time, even more so if one is attempting to change it from afar. FCO minister Ian Pearson told the House of Commons: “The objectives of the UK China Human Rights Dialogue are long term and ambitious” (UK Parliament 2005), implying that they should not be judged on short-term impact. The FCO itself only claimed that the dialogue made “incremental progress”, rather than a more substantive change (FCO 2004: 51).

In spite of the lack of immediate impact, the UK government have been positive about the impact of the human rights engagement. Derek Fatchett told the House of Commons (UK Parliament 1998):



“This dialogue has led to “tangible results” including China signing the international covenant on economic, social and cultural rights; the release of Wei Jingsheng;<sup>1</sup> and various UN visits.”

During the Cameron premiership, the FCO said of the dialogue:

“The dialogue is an important channel for our concerns and supports the other pillars of our engagement, informing our lobbying and project work and helping to strengthen our working relationships with relevant ministries.” (FCO 2012: 137)

The FCO view all three pillars of the human rights engagement together, as part of their overall constructive engagement with China. A government minister who was interviewed concurred with the views expressed by successive governments, saying:

“It was effective to the extent that you were forcing parts of the state machine to engage on questions that they weren’t necessarily comfortable with and wouldn’t have done it willingly. So I think there was some benefit, but I don’t think we should be naïve and underestimate the degree of challenge in moving the monolith, which is the Chinese state” (Interview 2016)

Therefore both the government minister and the FCO agree that the dialogue was worth doing, although they understandably are cautious of saying it was more effective than it was in making a large difference to China’s human rights.

However, it is wise to doubt the effectiveness that the engagement, particularly the dialogue, had. Zinzelbach’s (2015) arguments about the EU-China dialogue, explained above, can also be applied to the UK-China Human Rights Dialogue. Human rights dialogues from various countries and IOs have led the Chinese government to maintain a dedicated team of relatively junior diplomats who are well-practised at responding to human rights criticism. The existence of this team does not in itself actually improve human rights in China and may actually isolate more senior politicians from these issues.

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<sup>1</sup> Wei Jingsheng is a prominent Chinese human rights activist who spent a total of eighteen years in prison as a political prisoner. Since being released in 1997 after international pressure, he has lived in the United States.

Two things were achieved from this engagement, however. The main benefit from the engagement was arranging the specific project support that the UK offered that had meaningful impact. As explained above, there were specific projects that the UK and China worked together on to improve human rights in China, such as around prisons and the criminal trial process. Some newly build prisons are better designed than they were twenty years ago, improving prisoner rights, and British support played an important part in this. All of the specific projects required central coordination or progress reports to be given. Close engagement between the two governments, including a regular human rights dialogues between the foreign ministries of the UK and China, was useful to do this.

Secondly, while the dialogue had some, albeit limited, value in the bilateral game, it did have value in the UK game as the government could claim to be doing something. The dialogue was given as an example of action in response to parliamentary questions (eg UK Parliament 2004). This dampened the domestic criticism that the government were not taking human rights seriously enough. This also comes back to the point about human rights being part of UK political culture so the UK government wants to think of itself as promoting them abroad. Voters are generally more concerned with their living standards than they are with international human rights issues, but successive governments still promote them because they believe it is the right thing to do.

Of course, the lack of significant change was made even harder by the relative shift in power over the period. As argued throughout the thesis, the UK has declining power relative to China and is increasingly dependent on China for economic deals. China has become more powerful and less sensitive to the decisions made by Western governments compared with twenty years ago. China's power in the global political economy means that it is more difficult to successfully engage with China on human rights issues.

#### **4.8 Conclusion**

This chapter has argued that the UK and China have very different conceptions of human rights, but that the UK has attempted to improve human rights in China as the UK sees them. This has happened through the EU, global governance institutions and bilateral engagement, including a human rights dialogue, working together on specific projects and high-level engagement. None of these methods has had overwhelming impact on China's human rights record, although the UK-China dialogue has seen small changes on specific issues where the UK was able to provide expertise. The most effective channel has been global governance because it is seen by China as more legitimate and avoids the 'race to the bottom' problem that bilateral dialogue is subject to.

In terms of how relations have changed throughout the period, the main change is that it has become more costly for countries to publicly criticise China's human rights record. China's power has grown and the UK is more dependent upon China for economic deals, therefore making the UK more sensitive to Chinese government decisions. Cameron specifically did not criticise China's human rights record in public for this reason (Interview with government minister 2018). The main driver of change was the growth in China's economy and greater assertiveness in rebuking human rights criticism.

Something not emphasised so far in this chapter, but which the research highlights is the way in which perceptions of China's human rights development have changed. In the introduction, it was argued that perceptions of China in the West have changed from an optimism that China would liberalise politically in the 1990s to constructing China as a threat in the 2010s (eg Friedburg 2018). This is truer of human rights as it is of any of the other topics in this thesis. In the mid-1990s, Andrew Nathan (1994: 622) talked of China becoming a "taker of human rights", predicting that China would accept and even adopt the existing human rights norms. Statements from Bill Clinton (2000) around the time of negotiations over China's WTO entry concurred with this view.

This argument is grounded in Manchester School of liberalism, which says that free trade leads to social benefits (Way 1999). This means that economic engagement with China through trade and investment flows will lead to political liberalisation.

Economic engagement mean that norm diffusion from the UK/ the West is more likely, spreading democratic norms through China. Economic engagement is also likely to strengthen the Chinese middle class and empower private interests in China, both of which contribute to democratisation (Jones 1998). Thus, even without a human rights engagement, economic links would lead to political liberalisation.

By the 2010s, this theory had lost popularity as there was little evidence for political liberalisation in China. Indeed, human rights in China may well have fallen as Xi has shown to be more authoritarian than previous presidents. Rather than talking about China adopting international norms, the emphasis has shifted to how international norms with adapt to China (Piccone 2018). Democratisation in China is, in this view, far from inevitable. Instead, China's rise might lead to de-democratisation as China's undemocratic political norms spread across the world. The optimism of the 1990s has moved onto the pessimism of the 2010s.

It is still too early to tell what the long-term political impact of China's economic engagement with the global economy is. The nature of democratisation is that it takes a long time – indeed, many Western countries took hundreds of years to fully democratise. It is inevitable that in the course of a country's political development that there are fluctuations and not a simple, linear progression. This means that a researcher cannot take a period of a few years and extrapolate the trend. For human rights in China, it is difficult to take the last few years and assume that human rights development will continue on the same path.

The Manchester School liberal model has not – so far – shown itself to be effective in predicting political change in China. It has failed to appreciate the philosophical differences between China and the West and how this affects political development. However, the 'complex interdependence' model and how it analyses power has been useful, as it explains the power shift that has occurred between the UK and China. Before the financial crisis, China was dependent on the West and so had to engage with Western-led human rights dialogue. In the 2010s, the UK and other European countries have become more dependent upon China and so human rights criticism of China stopped. Both of these trends show that human rights was never the most

important issue for either side, but rather a secondary issue that occasionally becomes visible. The next topic is a much more important issue to both sides: trade.

## **Chapter 5: Trade**

### **5.1 Introduction**

Chapter four established the political context for UK-China economic relations by discussing human rights and democracy. There are ideological differences between China and the UK on the conceptualisation of human rights, which is reflected in each domestic game and the preferences of each country. Human rights promotion is a stated goal of British foreign policy, and the UK has promoted human rights in China through a human rights dialogue in addition to high level engagement and work on specific projects. However, promoting human rights unilaterally is challenging, particularly since the economic crisis when China has become more assertive and sought to play countries off against each other. This is most clearly seen during 'the freeze', when China sought to punish the UK diplomatically because Prime Minister David Cameron met with the Dalai Lama in 2012. The most effective form of human rights engagement is multi-nationally, using international institutions such as the UN.

This chapter looks at trade. At its most basic level, "international trade is the exchange of goods and services between countries" (Investopedia). This definition is straightforward, however complexity arises when companies invest for the purpose of exporting, which blurs trade and investment. The iPhone for example is made in China and exported from China around the world, but is designed and owned by Americans (Kraemer et al 2011). Koopman et al (2008) estimate that the share of foreign content in China's total exports is about 50%, with exports in more sophisticated sectors such as electronic devices being about 80% foreign content. The bilateral UK-China trade statistics must be looked at in the context of the wider international political economy, including with investment. There is a blurring of trade and investment issues, but that is kept in mind throughout the chapter.

Before the financial crisis, trade was the most important issue in UK-China relations and, unlike investment and finance, was a central issue for the entire of the period

being studied in this thesis. Anecdotally, the phrase “made in China” is commonly seen on household items in the UK, reflecting the importance of Chinese imports to the British economy, typically on cheap goods. Increasingly, British products are also being consumed in China, as Chinese demand for Western products grows as China’s middle class grows. That trade has increased significantly in both directions is entirely unsurprising, since China’s trade with other Western countries has increased at a similarly significant rates. The main cause of this increase in trade is China’s growth and China’s reduction in trade barriers brought about by WTO accession in 2001.

In addition to current trading arrangements, there is also a norm in the UK about China’s growth making China even more important for the future. An October 2015 YouGov poll showed that 29% thought that China would be the UK’s most valuable trading partner in twenty years’ time (YouGov 2015), higher than any other area including the US and the EU. Much of the UK’s desire to export to China comes from a perception that China is a growing market full of money-making opportunities, as is the case with investment and finance as will be discussed in chapters six and seven. The present reality does not necessarily correspond to future perceptions however, and it will be argued in this chapter that the vast majority of British businesspeople come away disappointed from entering into the Chinese market because of the gap between perceptions and realities.

This chapter will proceed as follows. The next section looks at the UK and Chinese domestic games, focusing on how trade has increased and the domestic changes this has caused. These include the losers of globalisation in the UK, the boost that Chinese imports have had on UK consumerism and the growth in China’s consumer base. The fourth section, the EU game, is arguably the most important because the EU has competence for making trade policy for all EU states, and so represents the UK. The highest game, international organisations, mainly concerns the WTO and China’s accession to it in 2001. The chapter then looks at how all of the levels fit together in the bilateral game before offering some concluding thoughts.

## **5.2 UK Game**

The UK has historically had a highly internationalised economy, with a higher proportion of its economy made up of international trade and finance than other countries of similar size (Hirst and Thompson 2000). However, since trade policy is a competence of the EU, UK government policy is entirely constrained; the UK game cannot result in direct policy changes and so can only have a weak impact upon UK-China trade. The UK government can assist companies in exporting to China, and it has, but cannot affect imports into the single market. Trade with China had a significant economic impact, creating mainly winners through cheaper imports but also with losers who were employed in outsourced industries. This section discusses these trends.

### **5.2.1 Domestic Losers**

The UK has seen an influx of low value, Chinese imports over recent decades as part of a globalised system of production. Economic theory and liberal IPE do well at explaining the link between globalisation and domestic distributive effects. David Ricardo's (1817) theory of comparative advantage shows that trade can make countries better off on aggregate, but the domestic industries that do not have the comparative advantage lose out. The Stolper–Samuelson theorem states that a price increase for a particular good improves the return to the main factor of production, but worsens the return to other production factors, thus causing a domestic distributional impact (Stolper and Samuelson 1941). The 'Dutch disease' occurs when, through an increase in the exchange rate, the success of one sector of a country's economy leads to the decline of other sectors (Bresser-Pereira 2008). Dani Rodrik (1997b: 2) had argued that globalisation exposes a fault line between highly educated people, who have the skills to compete internationally, and those who don't. Therefore, according to liberal theory, international trade has the effect of exacerbating domestic inequality while improving overall efficiency.

This is true of the UK economy and Chinese imports. There have been many winners from trade with China, both businesses who can reduce their costs and consumers who benefit from cheaper prices, as this section discusses below.



However, there have also been losers, from sectors of the economy that have lost out to Chinese competition. This is particularly true of manufacturing, as a million fewer people were employed in manufacturing in the UK between 2002 and 2010 (House of Commons Library 2018), as shown in the table 3 below. This period coincided with a dramatic rise in manufacturing jobs in China from 40 million in 2003 to 58 million in 2010 and 80 million in 2014 (Lardy 2015). It is difficult to prove the exact number of individual jobs in the UK that were lost to China, but it can be said that the expansion of the Chinese manufacturing sector put significant downward pressure on the UK manufacturing sector. The lower wages in China make its manufacturing sector more internationally competitive.

*Table 3 - Number of UK manufacturing jobs (House of Commons Library 2018)*

Year	Millions of jobs in manufacturing in the UK
1982	5.47
1992	4.28
2002	3.64
2005	3.12
2010	2.57
2015	2.64

An example of the losers of globalisation, where Chinese exports have undermined a UK industry, is the steel industry. The UK steel industry continued its long decline, with production falling by a third between 2000 and 2015 (World Steel 2002; 2015; Groom 2016). A major reason for this was competition from China, which increased more than six-fold over the same period and led to a doubling of global production (World Steel 2002; 2016). China produced steel more cheaply because of lower labour costs (Song and Liu 2012: 134). Steel became a newsworthy issue in 2015 when, at a similar time to Xi's visit, Sahaviriya Steel Industries went into liquidation and Tata Steel began selling off parts of their British steel operations, with a combined 3,300 job losses (Rhodes 2016; BBC 2016; *Guardian* 2015, October 2nd; 2015 October 20th).

China was blamed for the job losses in the UK steel industry, and allegations were made of Chinese dumping, as oversupply of steel in China was being sold on world markets at a loss (*Guardian* 2015, 28<sup>th</sup> September; BBC 2015, 21<sup>st</sup> October). David Cameron responded to the domestic pressure by saying he wanted “a strong and robust British steel industry” (UK government 2015). Unfortunately for the British steelworkers, post-Thatcher governments have stuck to a liberal policy framework and have been unwilling to provide large public subsidies for industry. The dumping argument should not be overstated however. Even if there had been a level playing field, the wage differences meant that the market would still have forced their decline (Brown et al 2010; IMF 2018). This example broadly fits into Rodrik’s (1997b) model of a divide in Western countries between the skilled workers able to compete internationally and unskilled workers who cannot.

### **5.2.2 Finance and Trade**

In the UK game, one of the reasons why imports from China increased is that British consumers were able to take on more debt. As will be discussed in chapter seven, the changing nature of finance and financial markets meant that debt was cheaper and more accessible. Since the 1980s, there has been a ‘financialisation’ of the UK economy (Davis and Walsh 2016; Palley 2013), which had the effect of households accessing more debt, since the financial sector was empowered to create more credit (Davis and Walsh 2016: 667). Figure 7 below shows that household debt increased from 85% of income in 1997 to a peak of 148% of income in 2008 (ONS).

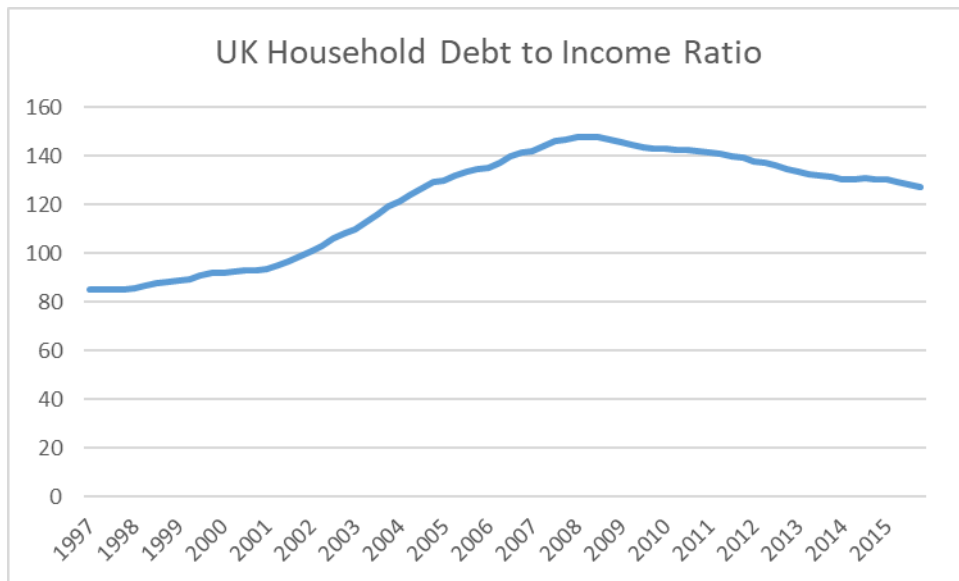


Figure 7 - UK Household Debt to Income Ratio (ONS)

This debt increase allowed British consumers to spend more, including on Chinese imports. The overall pre-crisis pattern was Western countries imported low value goods from China at an artificially low price, then a large proportion of this money was saved in China. During the ‘global savings glut’, China began to accumulate savings which, although primarily recycled into US treasury bills, had the effect of lowering global interest rates (Bernanke 2005). These lower interest rates made borrowing cheaper for British consumers, and allowed households to take on more debt as shown above. This pattern has mainly been discussed in reference to US-China relations (eg Roach 2009; Weede 2010; Morrison 2011), but it also applies to UK-China relations too, and had the effect of increasing UK imports from China.

### 5.2.3 Benefits from Trade

The UK has derived considerable benefit from low value imports from China. Having millions of cheap goods being imported allows for British consumers to buy goods at cheaper prices, which increases consumers’ purchasing power, as well as increasing consumer choice, such as with Chinese food (Mintel 2015). Easy access to credit was important, as explained above, as were the factors from the other games explained below. These factors contributed to a new phase of consumerism –

indeed, perhaps a new era of globalisation (Stearns 2001; Friedman 2006: 10) – that China played a vital role in. These trade trends have had an impact on UK society, arguably the biggest of which has come from the vast increase in manufactured goods being exported from China. As figure 8 below shows, there was a substantial increase in the volume of manufactured goods and articles from just £2.1 billion in 1997 to £36.6 billion in 2016, representing a seventeen-fold increase. These manufactured goods include a wide range of products including mobile phones, cameras, clocks, computers, clothes, shoes, toys, furniture, vehicles and machinery. This trend is a defining feature of the UK-China economic relationship.

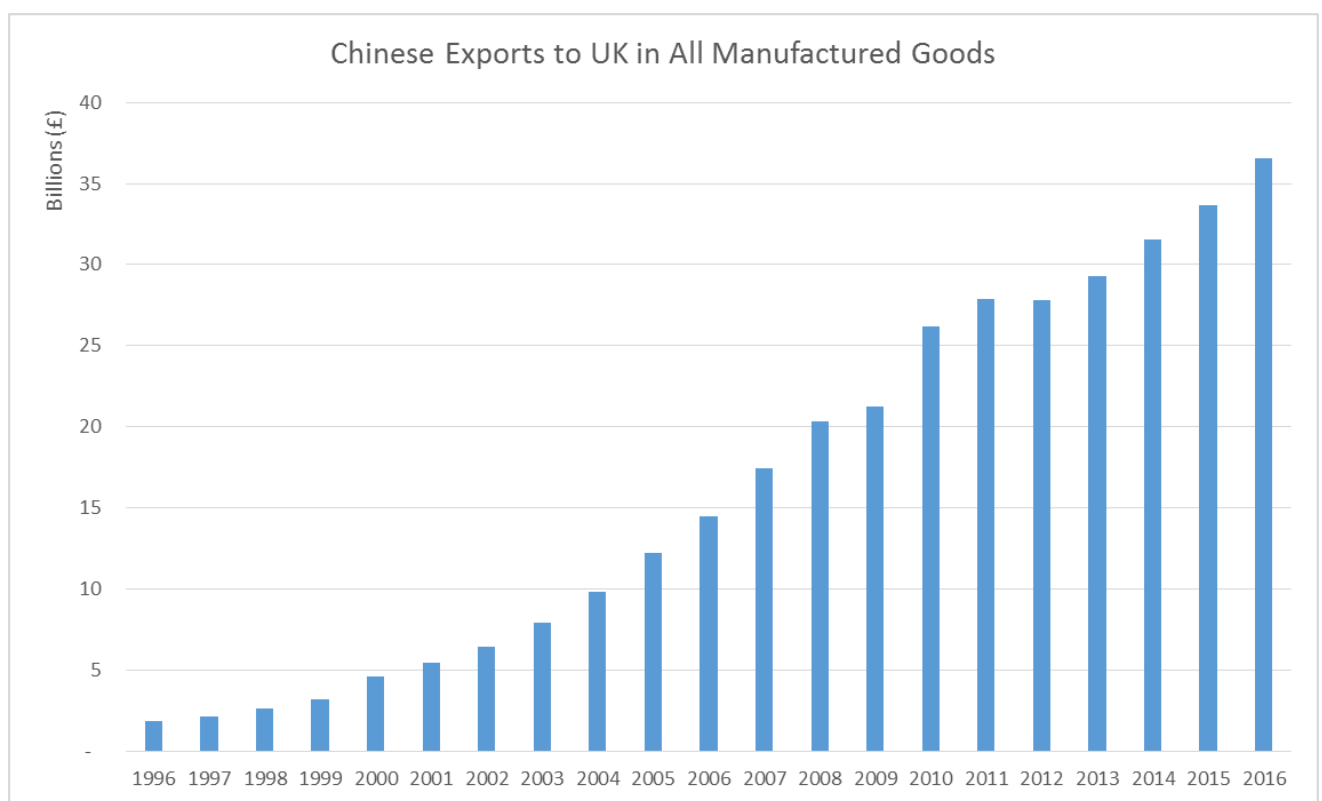


Figure 8 - Chinese Exports of All Manufactured Goods to the UK (Source: HM Revenue and Customs)

This increase in Chinese imports can be associated with the significant increase in the proportion of UK households that had mobile phones or computers. As figure 9 below shows, ownership of both devices has grown: in 1997, only 20% of UK households owned a mobile phone and 29% owned a personal computer; by 2015, 95% of households had a mobile phone and 88% had a home computer (ONS). Of course there are a number of causes of this rise – with improvements in technology

obviously being important – but this illustrates the impact that China has had on the West. Given that in 2011 over 90% of all computers and over 70% of all mobile phones were made in China (Ciu 2011 cited in The Atlantic 2013), trade with China played a role in this era of consumerism.

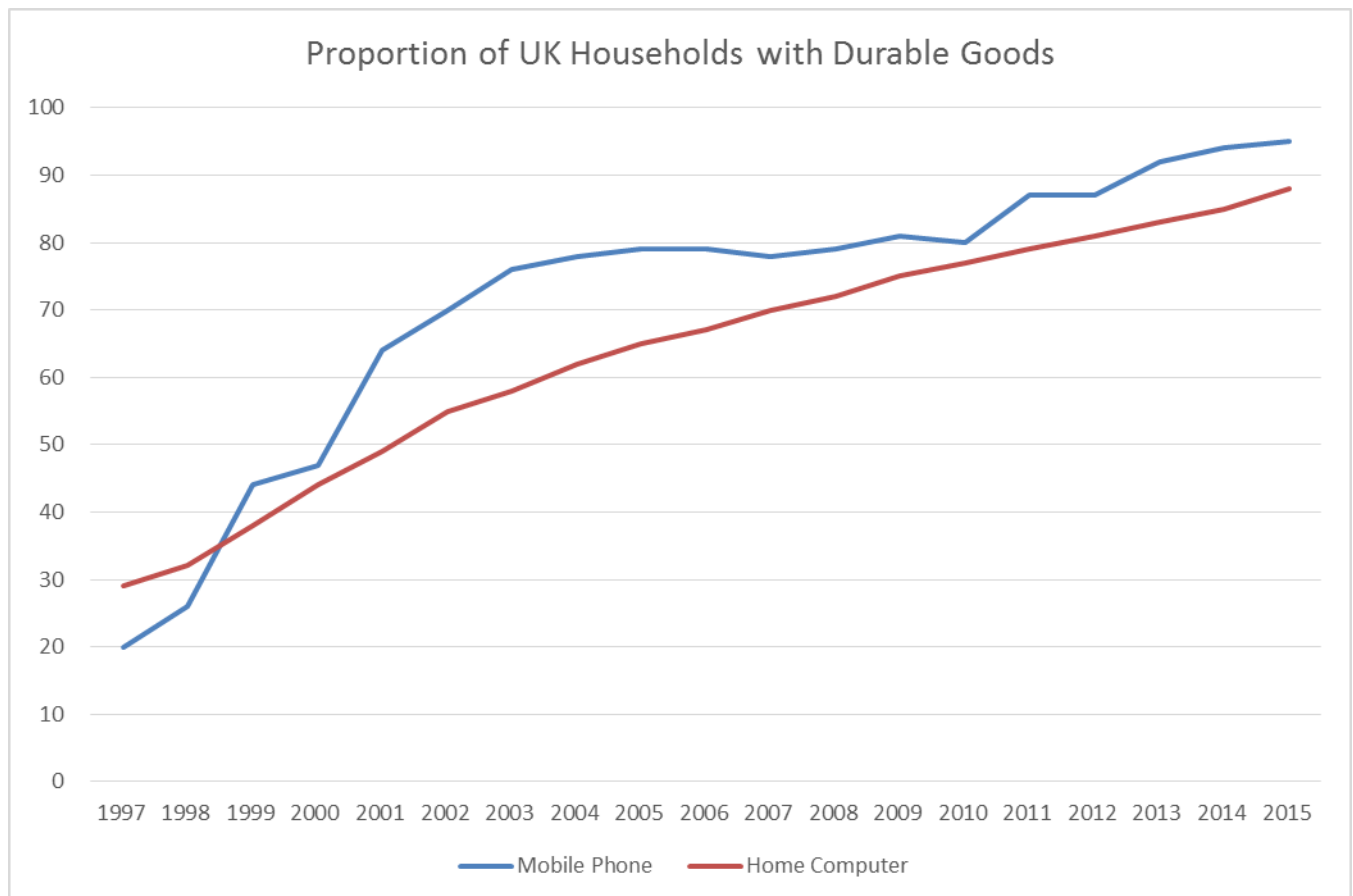


Figure 9 - Proportion of UK Households with Durable Goods (Source: ONS)

Similarly, China's clothes exports increased from 15% of the global total in 1996 to 38% in 2013 (WTO 1997; 2013), and that increase was reflected in the proportion of Chinese-made clothes in the UK. Chinese-made imports in telecommunications equipment, electrical appliances and office machinery has increased (House of Commons Library 2019). The competitive advantage that China has over other countries means that these products are produced at a lower cost than elsewhere. China also has a comparative advantage for manufactured products compared with the UK, given the UK's relative strengths in the service sector. Using Ricardo's (1817) model of comparative advantage, China producing goods that it has a

comparative advantage in increases overall volumes of production. China's industrial policy is another factor, which further advantages Chinese producers over UK producers.

The influx of Chinese imports has boosted the culture of consumerism in the West by providing a flow of low value goods. Within sociology, there is a large literature on the social impact of consumerism. Veblen's (1899) concept of 'conspicuous consumption' explores the link between consumption and social status. Zygmunt Bauman (2005) talks of "the new poor", refers to people who make the 'wrong' consumption decisions. Juliet Schor (1995: 74) has argued that consumption has an addictive nature, which leads people to forgo leisure time and work longer hours in order to increase their consumption – a phenomenon she terms the 'work and spend cycle'. Postmodern sociologists Campbell (2004) and Todd (2012) argue that consumption makes up part of a sense of self and therefore defines a person's identity. Michael Redclift (1996: 6) argues that increased consumption has a large environmental cost. All of these arguments reveal something about the social changes that consumerism has brought, and the flow of Chinese imports contributes to this.

The post-Thatcher governments have not sought to challenge consumerism, but have rather been influenced by it. Elizabeth Vidler and John Clarke (2005) argue that the "citizen-consumer" was established in the 1980s and affects the delivery of public services. Shaw (2009) argues that New Labour adopted consumerism with its own characteristics. In addition, both New Labour and the Coalition focused on economic growth as one of the main drivers of its policy. In his final budget as Chancellor, Gordon Brown boasted about how he delivered "the longest period of economic stability and sustained economic growth in our country's history" (UK Parliament 2007). Similarly, George Osborne boasted of "the strongest economic growth of any major advanced economy in the world" in his 2015 budget speech (UK Government 2015, 8<sup>th</sup> July).

Perhaps unsurprisingly, the benefit of low value imports was rarely mentioned by British politicians. Tony Blair regularly took credit for the strong economy up to the economic crisis, whilst not mentioning the imports from China. In his final party

conference speech, Blair (2006) talked about how he presided over “the longest period of sustained economic growth in British history”, while failing to mention cheap imports. In his memoirs, Blair (2010: index) mentions China twenty-three times, but never acknowledges the benefit that imports from China had on the British economy.

#### **5.2.4 Support for Exports**

As well as imports from China, UK businesses have also benefitted from being able to export to China, and have been supported by several groups. The most significant private group is the 48 group, which is a commercial group funded by its members (48 Group website). It aims to reduce the “cultural deficit” between China and the rest of the world and offer a network of contacts. Membership benefits include news and information, consultation with the Chairman and networking opportunities. The group benefits from close personal relationships between business and government figures from both the UK and China to operate. In 2005, Hu Jintao spoke at a 48 Group event in London and praised the work they did (48 Group website).

In addition to this private group, the British state supports UK companies exporting to China through four separate organisations. Firstly, Visit Britain works to promote Britain’s tourism industry (Visit Britain website). It is a non-departmental public body funded by the Department for Culture, Media and Sport. It provides market insights into Chinese tourists for British businesses, and advertises British tourist activities all around the world. Some of the services that it promotes are provided by private sector organisations, such as shopping centres or music events. Since being established in 2003, the work of Visit Britain has coincided with an increase in Chinese tourist visits to the UK from 64,000 in 2002 to 270,000 in 2015, as shown in figure 10 below. During the same period, the total spend of Chinese tourists increased from £80 million to £586 million (Visit Britain website). The increase in the Chinese middle class meant that visits would likely have increased anyway, but extra advertising would not have hurt.



Figure 10 (Source: Visit Britain website)

Secondly, the British Council is the “UK’s international organisation for cultural relations and educational opportunities” (British Council China website). Much of what the British Council does is around either language training or qualifications. For example, 10,000 English teachers in China took the British Council’s English language teacher training programme in 2014 or 2015, and 800,000 people in China have taken an exam through the British Council, such as the English Language test IELTS or the professional accountancy exam ACCA (British Council China website). However, the British Council also work to promote the arts around the world including hosting arts events in China. In 2015, the UK and China launched the first UK-China Year of Cultural Exchange. Arts events were hosted and supported by the British Council, a UK public body, but feature many private musicians and artists.

Thirdly, the China Britain Business Council (CBBC) helps British businesses working in China. They provide advice and expertise to over a thousand British businesses and have offices both in the UK and China (CBBC website). For example, the CBBC publishes a magazine, China Britain Business Focus, for its members which includes information about the Chinese market and doing business in China. The CBBC are partners with the UK government – particularly UKTI, whose responsibilities have



since been taken on by the Department for International Trade – and receive some public funding which allows them to carry out their work. Representatives from government bodies, such as the FCO, are “appointed observers” and listed with the board members on the CBBC website. The CBBC also offer visa support in both directions, which allows member businesses to access types of visas that they would not usually be able to access (CBBC website).

Finally, UK Trade and Investment (UKTI) was a non-ministerial government department that worked to help “UK-based companies succeed in the global economy” (UK Trade and Investment 2014). UKTI co-ordinated the government’s work on: supporting UK companies to export; supporting foreign investors who want to invest in the UK; and working with governments to make exporting and inward investment easier (UK Trade and Investment 2016: 5). The size of UKTI stayed stable at around 2,500 people, posted across the world (UK Trade and Investment 2006; 2016). China was a stated priority for UKTI (2006: 8) because it was a “high growth” country of “strategic importance”, and so it had particularly close connections to the British Embassy in China, and the consulates. In 2015-16, UKTI (2016: 15) received £7.5 million from the government to “unlock access to markets in China” in the “manufacturing, transport, financial services, healthcare and life sciences sectors”. In 2016, UKTI was replaced by the Department for International Trade, which has taken on all the roles of UKTI.

One of the features of all four of these organisations is that are public or quasi-public bodies promoting private business. There are two potential arguments for why this would be justified (Breslin 2004: 421). Firstly, that the growth of the Chinese economy gives the UK significant economic opportunities in the longer-term. Secondly, that the nature of the Chinese market requires private businesses to obtain government support to level the playing field. Both of these arguments are plausible, but neither of these arguments fits with a liberal view of ethics that successive governments have claimed to adopt. Outside of well-funded core public services, both New Labour and the Cameron administration believe that the market generally allocates resources in the most efficient way (Gamble 2012; Konzelmann and Fovargue-Davies 2013). With the decline of the steel industry, there was no government appetite to inject public money into supporting an uncompetitive

industry. With the members of the CBBC however, the government has an appetite to subsidise a range of services including research, visa support and providing networking opportunities that private businesses can make use of. This contradiction is not consistent with a liberal worldview that emphasises the equality of private actors before government.

Liberal theory advocates that policy makers should be mere arbiters between competing interests, and therefore be embedded from them. Government should not pick winners, since that is the role of the market (Burton 1983). In foreign policy terms, the focus by the UK government of partnering with private business in order to conduct foreign relations was referred to as a 'privatisation of authority' (Cutler et al 1999). Breslin (2004) argues that with the CBBC the distinction between public and private becomes blurred. Allison Stranger (2014: 2) argues that "the lines between business, philanthropy and government have grown ever more difficult to draw". Rather than liberalism, this is better classified as corporatism and mercantilism.

Part of this comes from the construction of China as inevitably having high future growth and becoming an emerging superpower. As argued in chapter two, there is no way of knowing how China will grow in the coming decades. This is where ideas come in, and the perception of China as an emerging superpower gives China opportunities and power that it otherwise would not have. With regard to trade, despite the relative lack of success that British businesses have in China (Brown 2019: 62), the government wanted to promote the Chinese market because they thought it was an area of future growth (UKTI 2006: 8). Once again, this shows that economic reality – in this case of a growing middle-class in China – is exaggerated by perceptions. This thin constructivist element is more important for investment and finance, as will be argued in the next two chapters, but still comes into the story of trade. It provides an explanation for why the Chinese market was still seen as a growth opportunity, despite the lack of success that British businesses have had (Brown 2019: 62).

Moreover, the thin constructivist element explains why the government were so determined to promote the Chinese market. UKTI (2006: 8) said their strategy was to "focus on high growth countries of strategic importance, such as China and India".

China's size and growth rate contributed to the perception of it being a country of strategic importance. As argued in chapter two, uncertainty forces people to build constructs to manage information about the future (Seabrooke 2007: 373). Both government and business have constructed China as a land of opportunity, despite the lack of a clear track record of success for British businesses in China. These themes will be discussed again in the next two chapters.

### **5.3 China Game**

Compared with the UK, China still has a relatively closed economy with a high level of government control. Despite significant liberalisation that has taken place since 1978, China does not have a market economy in the way that the West does. This was one of the justifications for the UK assisting exporters who want to sell to China. It also means that Chinese exports are controlled politically to a greater degree than in the UK. Naturally, China's growth has meant that both imports and exports have risen substantially throughout the last forty years.

#### ***5.3.1 Chinese Exports***

Exports have been a major part of China's economic strategy since the 1978 economic reforms. In 1980, the Chinese government set-up four Special Economic Zones (SEZs) that were intended to boost trade, as well as attract FDI and accelerate diffusion of new technology (Yeung et al 2009). Their success in boosting economic growth led to further SEZs being set-up. There was also foreign pressure for the Chinese economy to liberalise and a renewed government effort with Deng's 1992 Southern Tour. From around 1992, China significantly opened up to foreign trade, so by 1997 the large growth in exports had very much begun. The biggest change in Chinese trade policy then came as a result of the 2001 accession into the World Trade Organisation. As argued in chapter three, accession meant that trade barriers were rapidly cut: China modified more than 2,300 national laws and 190,000 local laws and regulations in order to comply with the accession agreement (Wang 2011). Of course, in return China received non-discriminatory access to foreign

markets, which made it much easier to export goods. This led to a rapid growth in Chinese exports to the rest of the world.

Figure 11 below shows the total Chinese exports to the rest of the world in the period 1992-2015. There are two features of this graph that are worth pointing out. Firstly, there is an upward trend throughout the entire period. Although there are downward spikes – most visibly during the global economic crisis – there is a clear upwards trajectory, which accelerates as time goes on. Secondly, the biggest sustained growth in proportional terms is the period 2001-2008, between WTO accession and the global economic crisis, when total exports increased from \$266 billion to \$1.4 trillion.

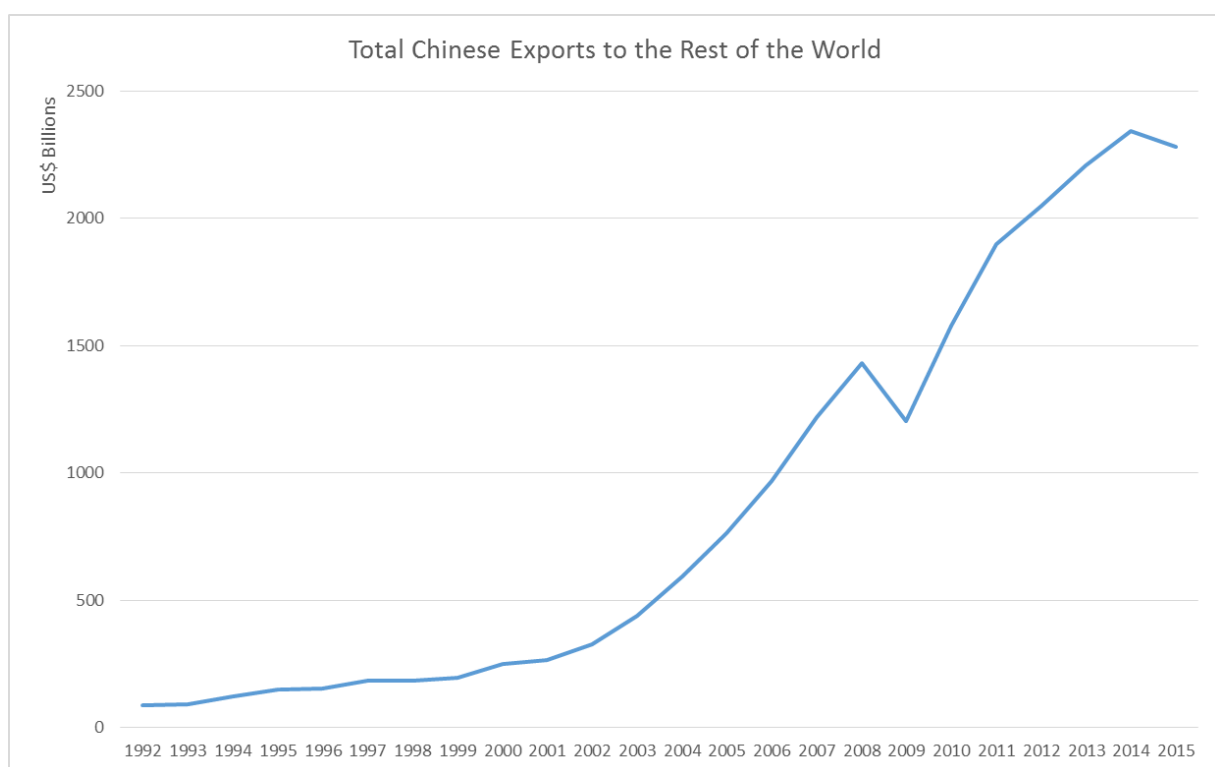


Figure 11 - Total Chinese Exports (World Integrated Trade Solution)

However this picture focuses on the whole of China and ignores the regional inequalities. Like with economic activity more generally, much of the trade is focused around the coastal regions of China. The province level is an important level of

analysis for studying Chinese political economy since the province plays an important role in economic policy making. Chen (2005) argues that the combination of decentralisation and internationalisation has transformed the provinces into “some sort of international actors”. Provinces have even set-up major bodies, Foreign Affairs Office (FAO) and Foreign Trade and Economic Cooperation Commission (FTEC), to manage external relations, the later having the responsibility to promote exports from the province.

This difference is partly caused by different economic models being used by different provinces (Donaldson 2009). Chongqing has been held up as an example of a municipality that used a highly statist, and in fact neo-Maoist, model of development (Wang 2013; Mulvad 2015; Cheng 2013). On the other hand, Guangdong became seen as a liberal, outward focused model of development, also benefitting from its geography (Yeung et al 2009; Mulvad 2015; *Economist* 2011). The different models – albeit with different geographies – have contributed to different levels of export, as shown in table 4 below, with Chongqing a net importer and Guangdong the biggest net exporter in China for 2004 and 2011, providing a quarter of China’s exports in 2016 (HKTDC Research). This difference helps disaggregate China and demonstrates the economic diversity within China (Breslin 2011; cf Ramo 2004). The table shows the net export data for all provinces, showing that the richer and coastal provinces are on average higher net exporters (Démurger et al 2002).

*Table 4 - Net Exports by Provincial-Level Division 1997-2011 (HKTDC Research)*

<b>Division</b>	<b>1997</b>	<b>2004</b>	<b>2011</b>
Anhui	-6.73	-11.82	-28.7
Beijing	-374.93	-221.1	80.2
Chongqing	-13.2	-435.67	-387.8
Fujian	-38.56	317.51	557.6
Gansu	-73.56	-176.4	-818.9
Guangdong	554.9	1487.9	6131.9
Guangxi	-26.45	-20.05	-3869.7
Guizhou	-194.03	-584.48	-966.2
Hainan	-6.1	1.24	-154.4

Hebei	375.06	1140.56	991.6
Heilongjiang	435.6	776.9	-892.2
Henan	216.72	239.77	-4018.6
Hubei	-79.13	-79.65	208.5
Hunan	15.39	-83.66	-332.6
Inner Mongolia	-7	-396.49	-2181.4
Jiangsu	734.12	818.63	3411.9
Jiangxi	-10.07	-54.56	119.8
Jilin	-12.4	-28.9	-1468.3
Liaoning	492.16	262.91	-570.7
Ningxia	-21.8	-213.63	-672.6
Qinghai	-46.89	-167.31	-589
Shaanxi	-29.3	-49.62	-1548.3
Shandong	127.7	997.14	2322.1
Shanghai	-210.99	457.99	645.5
Shanxi	50.9	-9.4	-881.9
Sichuan	1.62	-154.11	-465.4
Tianjin	-2.1	106.08	-1573.4
Tibet	-27.5	-140.8	-310.1
Xinjiang	-136.75	-266.5	-1071.1
Yunnan	-43.58	-410.96	-3519.4
Zhejiang	203.49	483.13	2533.3
<b>TOTAL</b>	<b>1846.59</b>	<b>3584.65</b>	<b>-9318.3</b>

### 5.3.2 Supply Chains

This disaggregation goes even wider when looking at the international supply chains. As argued in chapter two, modern economic activity is more likely to occur across different states, and this means that MNCs are more likely to be “geocentric” and/or goods to have come from complex supply chains spanning multiple countries. As Kooperman et al (2008) find, only 50% of China’s exports are actually add value to the Chinese economy; the other half being foreign content. Therefore, the trade statistics overstate the impact that China’s exports have on its domestic economy.

A well-cited example of this internationalised supply chain is the Barbie doll (Tempest 1996; State Council 2002; Breslin 2007: 145). In the 1990s, Barbie dolls were being made in China and sold in the United States and Europe for \$10. Of the \$10, \$1 per doll went as profit for the American toy company Mattel, \$2 went towards production costs and \$7 went on transnational and domestic transport, advertising and other costs that benefit Western economies. Since the final production stage came from China, the international trade statistics would show a \$2 export from China to the US. However, China was only one stage of the production process: the vinyl plastic pellets that became Barbie's body were made in Taiwan using Saudi Arabian oil; the hair was made in Japan; the cardboard was produced in the US; and the production process was managed by Hong Kong. Thus, while China exported a \$2 finished product that sold for \$10, only 35 cents actually went to the Chinese economy.

Furthermore, around half of all Chinese exports come from foreign-invested firms (Huang 2001; Chen and Shih 2005: 103). As will be discussed in chapter six, foreign-invested enterprises play an important role in China's economy. If a foreign company sets up a factory in China and then exports the goods back to Western countries, the benefit for the Chinese economy are limited to wages and land costs. In chapter six, the example of Dr Martens is discussed in which the UK firm relocates its manufacturing to China to reduce production costs, then sells the goods all around the world, including back to the UK. A Dr Martens sale in the UK would technically count as a Chinese export, even though it is a UK brand. The increasing complexity of supply chains make it harder to disaggregate China's exports.

### ***5.3.3 Currency Manipulation***

One of the most talked about aspects of China's economic foreign policy is its currency manipulation, which started in 2003 (Frankel 2016: 168). This affects all three of the topics discussed in this thesis, but will be discussed most fully in chapter seven, but is discussed here in relation to trade. By artificially lowering the value of its currency, China makes it more expensive to Chinese consumers to import foreign goods and cheaper for foreign importers to buy Chinese goods (Krugman 2010a).

This results in a higher level of Chinese exports and lower level of Chinese imports that would be the case if China had floating exchange rates. There is debate over the extent to which China's currency was undervalued, as will be discussed in chapter seven, but China did have a trade surplus as shown in figure 12 below.

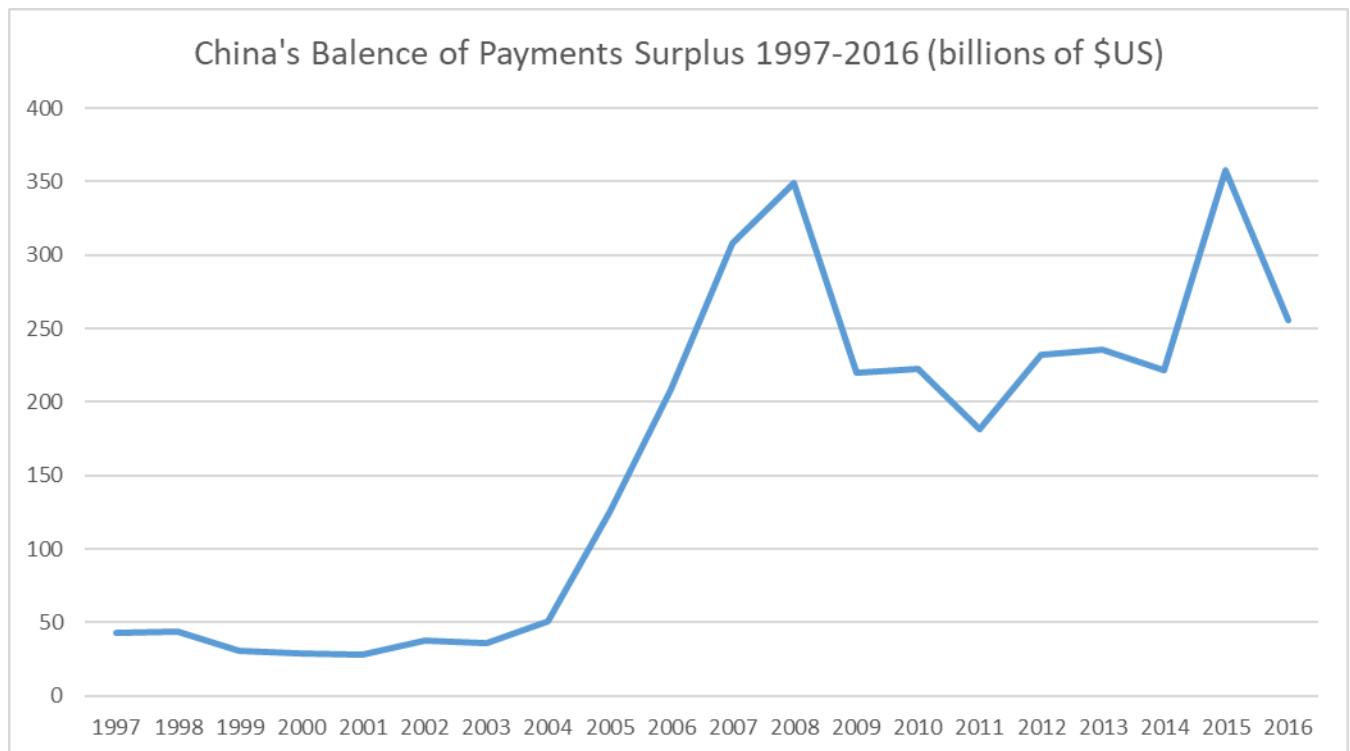


Figure 12 - China's Trade Surplus (World Bank data)

China's currency manipulation and trade surplus has a significant impact upon the West. China's surplus is associated with a trade deficit in the West, particularly the US but also the UK and some other European countries. On one hand, this gives the west buying power which allows higher consumption than would otherwise be the case. The recycling of China's surplus into Western economies also contributes to the cheap credit that Western consumers had used to buy Chinese products. However, there were also disadvantages for Western economies; imbalances with China was one of the causes of the 2007 global financial crisis (French et al 2009; Overholt 2010) and the trade deficit made it harder for Western economies to recover after the economic crisis (Krugman 2010b).



China gradually reduced its currency manipulation after facing significant criticism for it among international leaders. China moved to a managed peg system in July 2005, before halting appreciation in July 2008 due to the economic crisis, then resuming appreciation in June 2010 (Morrison and Labonte 2013). Between July 2005 and June 2013, the renminbi had appreciated by 42% on a real basis against the US dollar. Indeed, by 2015, China's currency may have been overvalued (Zhang J 2015). The appreciation meant that China's exports were not as internationally competitive, but that the buying power of Chinese consumers increased. This, along with the growth of China's middle class, is one reason why China's imports became more relevant in the 2010s.

#### ***5.3.4 Growing Consumer Base in China***

The growing Chinese engagement with the global economy has not just affected exports; Chinese imports have grown too. This has coincided with a cultural change towards Western-style consumerism within China that has affected Chinese society (Ngai 2003). Deborah Davis (2005) has argued that Chinese urban residents have experienced a "consumer revolution at multiple levels" because luxury items such as refrigerators, colour televisions and washing machines became much more widely owned. In global terms, Arjun Appadurai (1990) argues that globalisation has led to a "cultural homogenisation". China has undergone a "McDonaldization" (Watson 1997) and "Coca-colonization" (Ger and Belk 1996), certainly compared with the economy under Mao (Griffiths 2013: 12). China has still retained its unique culture, and consumerism in China continues to be different to the West (Griffiths 2013; Zhang W 2015), however China's cultural direction is increased homogenisation.

Underpinning the consumer revolution is a significant increase in China's GDP. China's disposable income per capita increased from 5,100 RMB in 1997 to over 30,000 RMB in 2015 (Trading Economics). Of course, this is not equally distributed among China's population, and is skewed towards already wealthy people, and also skewed towards the richer provinces of China, especially coastal provinces. The number of people that can be described as "middle class" in China is increasing rapidly, although definitions vary. The number of people earning more than \$10,000

per year rose from less than one million in 2000 to 500 million in 2018 (LGIM 2018). Using a middle-income threshold of \$10 per day, Kochhar (2015) argues that there were 203 million more middle class people in China in 2011 than in 2001. McKinsey predict that the number of affluent or upper middle class people in urban areas, with incomes above RMB 106,000 in 2010 prices, will rise from 44 million in 2012 to 225 million in 2022 (Barton et al 2013). Each of these estimates are showing slightly different things, but the overall trend is clear that the size of China's middle class has grown significantly.

This means that the Chinese market has increased in size and average incomes, leading to higher Chinese demand for higher-end, Western goods. However, while this consumer base is important, it was perhaps less important than is commonly assumed. At the beginning of the period in 1997, China's total imports were lower than the Netherlands and Canada (World Bank data), and in 1998 the UK's exports to China were lower than its exports to Finland (Breslin 2004: 420). Even at the end of the period, China's GDP is still considerably lower than either the US' or the EU's (IMF 2018), and a lower proportion of this is disposable income to spend on Western-made exports. This is again a case of perceptions of China's future affecting ideas about China's present. China's importance as a global market has been exaggerated by the social construction that it is a rising superpower.

### ***5.3.5 Chinese Demand for British Goods and Services***

As argued in the UK game section, there are two ways in which UK exporters access the Chinese market. The first is directly, if the market being sold to has open trade access. The second is through investment – whereby a UK firm will invest in China to access the market from within to overcome Chinese regulations on imports. Investment is covered in the next chapter, but for the purposes of trade, this market-seeking investment is particularly relevant to manufacturing. Figure 13 below shows UK manufacturing exports to China increased from £800 million in 1997 to £9.6 billion in 2014, with the steepest increase between 2009 and 2014 (HM Revenue and Customs).

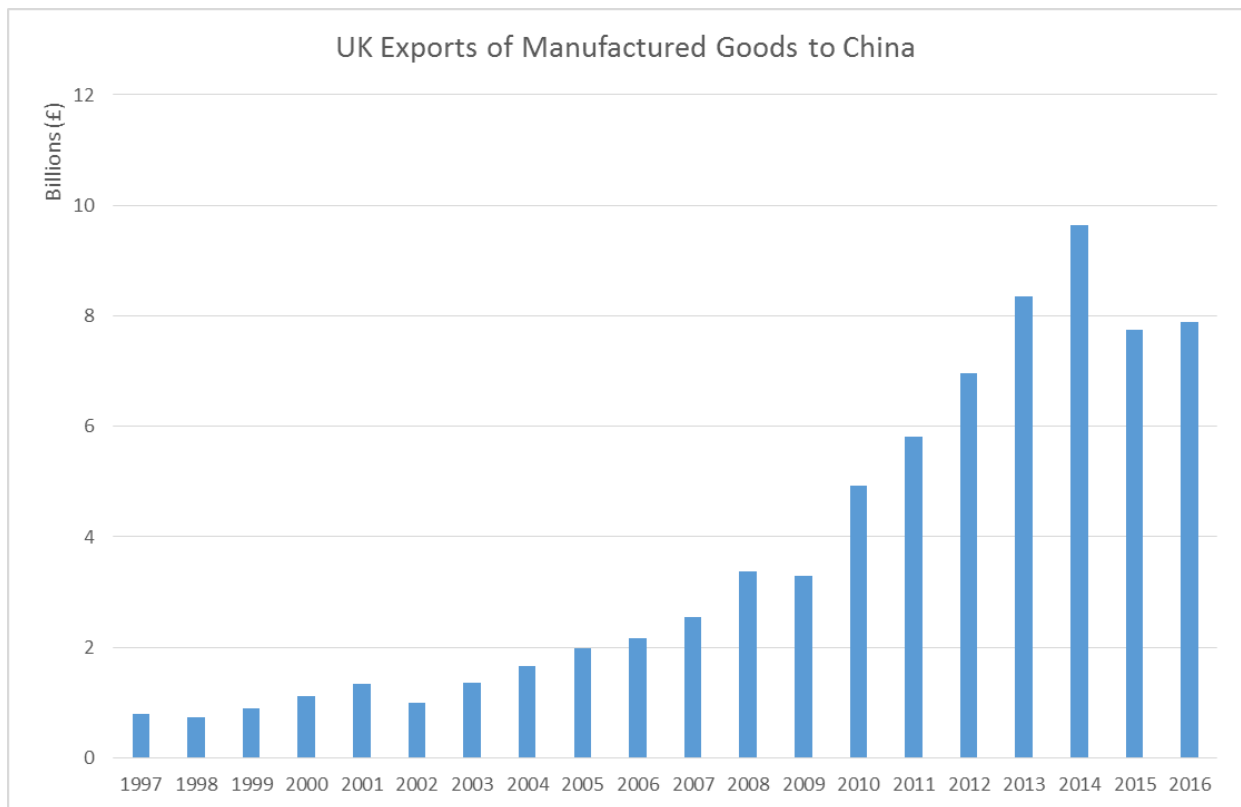


Figure 13 - UK Exports of Manufactured Goods to China (HM Revenue and Customs)

The growing middle class in China has led to an increased demand for British exports. Rising incomes leads to higher consumption, particularly of luxury goods, which British goods are perceived to be. Stephen Phillips, Chief Executive of the CBBC, argues that “Chinese partners value the quality of British goods and services” (CBBC 2014: 2). The Centre for Economics and Business Research (2014) shows that worldwide the “made in Britain” label is associated with quality and customers in developing countries are willing to pay a premium of up to 7% for it. Three industries in which the perceived quality of British goods has led to increased British exports are food and drink; film and entertainment; and education.

UK food and drink exports to China have more than quadrupled during the decade between 2006 and 2016, as shown in figure 14 below, reaching £440 million in 2016 (Food and Drink Federation website). The fastest growing products have been dairy, pork, beer and tea, all luxury food products (Department for Environment, Food &

Rural Affairs press release 2015; National Farmers Union website). The CBBC (website) say that concerns about poor safety standards and quality of Chinese food make British food, which is perceived as being of a higher standard, more attractive to middle-class Chinese people who can afford it. This fits the overall argument made above.

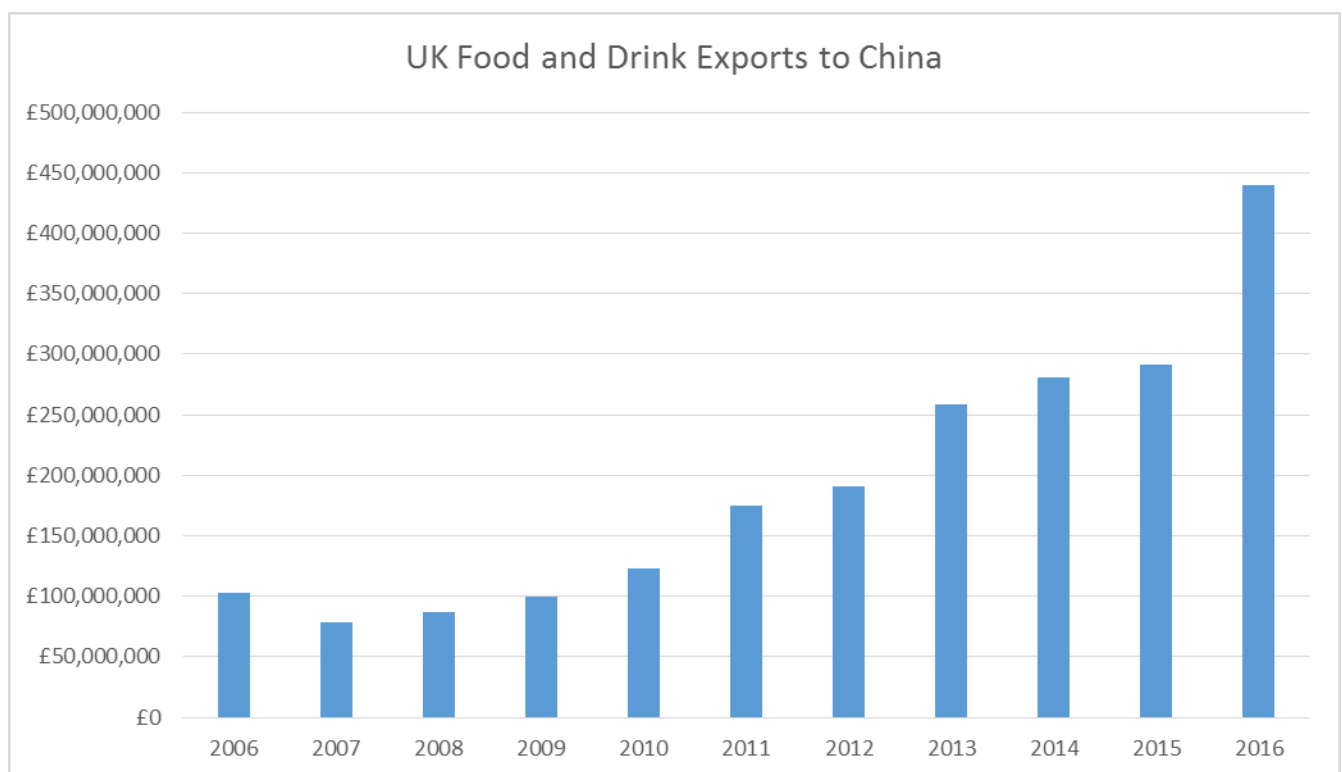


Figure 14 UK Food and Drink Exports to China 2006-2016 (Food and Drink Federation)

A second industry is film and entertainment. As the Chinese middle class has grown and its culture has become more Westernised, demand for foreign films and programmes has increased, particularly towards the end of the period. The number of movie screens in China increased from 12,407 in 2013 to 50,776 in 2017 (Song 2018) and the Chinese film industry have shown more leniency showing foreign films (Zheng 2018). The main beneficiary of this was Hollywood, but UK-made films and programmes have still benefitted from greater exposure and access. In the 2010s, there has been more success, for example the 2012 James Bond film *Skyfall* grossed \$60 million in China (Box Office Mojo). In 2014, the UK and China

negotiated a co-production treaty, which allowed British-Chinese co-produced films to have easier access to the Chinese market (BFI 2014).

Other forms of British television have also grown in China over the period. The English Premier League's Chinese appeal increased significantly: CCTV began broadcasting the Premier League in 2005 (Hong and Zhouxiang 2013: 1649) and by 2016, the English Premier League sold TV rights to the video-streaming Chinese broadcaster PPTV for £564 million (*Guardian* 2016, 18<sup>th</sup> November). Manchester United Football Club have developed a particular following in China, with their Weibo page now having 9.5 million followers (Weibo). Xi Jinping's supposed "soccer dream" (Lu 2016) has appeared to result in plenty of business for English football (BBC News 2016, 28<sup>th</sup> September). The show *Downton Abbey* has also found particular success in China with a reported 160 million people in China having watched the show (*Express* 2013, 4<sup>th</sup> August).

The third industry for which China's demand has seen a dramatic increase is education. There was a substantial increase in the numbers of Chinese students studying in the UK, both in secondary schools and in universities. Kerry Brown (2016: 23-25) describes this as happening "almost entirely by accident" for reasons including the high reputation of UK universities, the straightforward visa process (particularly compared with the United States post-9/11) and the advantage of all courses being taught in English. Figure 15 below shows a 150% increase in first year Chinese students in UK universities from 25,000 in 2006/07 to 62,000 in 2015/16 (HESA). This increase – which has financially benefitted the UK university sector (Universities UK 2017) – is described by Brown (2016: 24) as being "perhaps the most visibly successful part of the bilateral relationship".

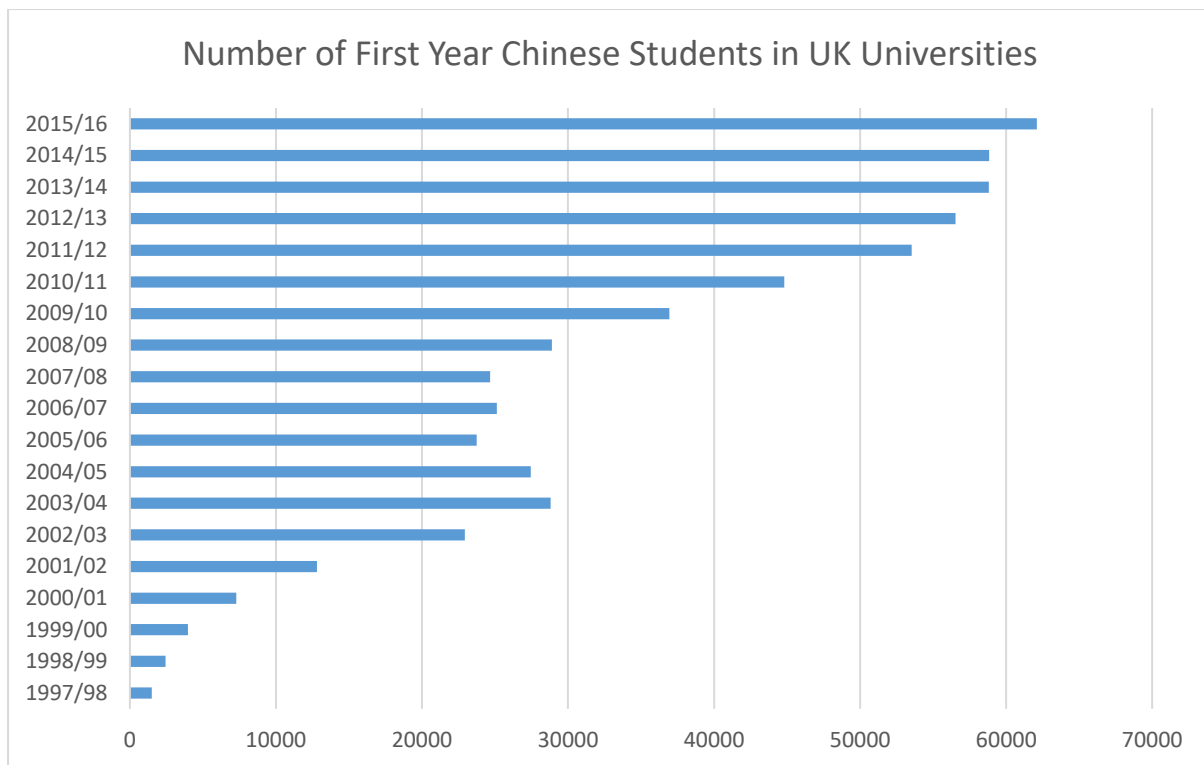


Figure 15 (Data kindly provided by HESA, used with permission)

A similar trend can be seen in British schools, albeit on a smaller scale. Figures from the Independent Schools Council (2017) show that there were 8,000 Chinese students studying in British independent schools in the 2016/17 academic year, in addition to almost 5,000 from Hong Kong. Of the students from Mainland China, 6,660 had their parents living overseas with the student often boarding, more than double the number compared with ten years previously (2,500 in 2007). Like with universities, top UK independent schools are perceived as being of world-leading quality and therefore desirable for Chinese elites to send their children to (Brown 2019: 53).

These industries reveal how the UK is perceived in China, since quality is a major selling point. Despite efforts from UK governments to present the UK as a modern hub of innovation, it can instead be perceived as being old-fashioned and elitist. Brown (2015: 8) argues “surveys show that Britain is still seen in China as a place more famous for castles, Shakespeare and the Royal Family than scientific discoveries and innovation”. This is not necessarily a problem for the UK given that

China have a growing middle class that has shown growing demand for higher-quality goods.

The thin constructivist element has some value in explaining Chinese demand for British goods. As Blyth (2002: xii) argues, ideas matter because they can change actor's conception of their self-interest and therefore shape preferences. The conception of British goods as high-quality, and of high-quality goods being desirable, changes the preferences of some Chinese consumers in favour of British goods. This gives a lift to British businesses seeking to export to China. It is difficult to distinguish between what is perceived as quality and what actually is quality, so it is difficult to test the extent to which ideas matter in relation to material reality.

#### **5.4 European Union Game**

Since trade policy is a competence of the EU, UK trade policy towards China was entirely constrained by the EU game. The common market and customs union meant that the EU has full control over goods that come into the EU. This means that the UK does not have a win-set on trade policy, since the UK government has no negotiating ability. The EU plays a more important role on trade than with human rights, investment or finance.

The main issue in the formulation of EU trade policy is that the diversity of states' interests within the EU means that it is difficult to reach consensus. This makes the liberal intergovernmentalism model effective because states are the primary actor in the decision making process and each state is concerned with their own economic interest, as explained below. As China has increased in assertiveness, the internal divisions within the EU have become even more apparent because of China's ability to 'pick-off' countries.

##### ***5.4.1 Regional Integration***

The EU is a model for regional integration, and has institutions to promote economic and political cooperation (Borzel and Risse 2009). As a regional institution, it treats member countries and external countries very differently, making it neither straightforwardly liberal or mercantilist. Bruce Moon (2000: 149) argues, “regional integration is best thought of as trade policy that is liberal on the inside and mercantilist on the outside”. There is free trade within the EU, but the EU is protectionist to external economies, particularly on agriculture and textiles (Oxfam 2002; Matthews 2010).

What allows the EU to do this is the size of its market, which reduces transaction costs when trading within the single market, and gives the EU a strong bargaining position when negotiating with external actors, which Damro (2012) has termed “market power Europe”. In addition, during negotiations, the EU is often able to add political demands on top, such as on human rights or the environment (Hafner-Burton 2005; Meunier and Nicolaïdis 2006; Peterson 2007). From each member state’s perspective, the benefits of not having trade barriers within the EU and better negotiation with external countries outweigh the differences in preferences between different member states. Generally, EU state’s preferences are fairly well aligned (Moravcsik 1998), although less so when dealing with China.

Divergence between EU member states has grown over time, and has not always been as stark. The European Commission (2001: 3) paper to the European Council that formally proposed approving China’s WTO accession noted that “it has long been the unanimously agreed policy of EU Member States to support China’s entry bid.” Prior to 2001, the potential economic benefits of lower trade barriers with China were so great, that not a single member state objected to China’s WTO accession. Some of the EU literature claims that the Commission is important in international trade (eg Smith 2008; Joachim and Dembinski 2011), however in the case of China’s WTO accession – one of the most important changes to world trade since the end of the Cold War – there is little evidence of the Commission playing a significant role in shaping the outcome of the agreement. Internally, the unanimity of member states in supporting China’s accession gave the Commission little room for manoeuvre. The agreeability of the EU reduced its negotiating power and meant that most of the concessions China made were forced by the US, rather than the EU. It is quite right



that the literature on China's WTO accession focuses either on domestic Chinese politics or on US-China negotiations.

#### ***5.4.2 Divergence of Interests of EU Member States***

After 2001, as China became a more important trade partner, differences between EU member states became more apparent. A divide emerged between producer countries that lost out from competing with China, and service or high-end countries that benefitted from buying cheaper goods from China. This makes an intergovernmental lens useful because of the way that governments disagree within the EU, which constrains EU action. This reduces the size of the EU's win-set, which helps explain why the EU were able to agree China's WTO accession but fail to reach agreement on a trade deal.

What makes the EU's trade with China more difficult than with other countries is that China plays a larger role in the global political economy, which makes for more pronounced winners and losers from trade. With regard to China, the EU's status as a "conflicted trade power" (Meunier and Nicolaïdis 2006) has become ever more apparent as China's position as a hub for global production has become more established. As Sophie Meunier (2007: 920) argues, the "steady rise in economic power of China" has changed the political context for international trade negotiations and made doing deals with China a more pressing issue. For trade, more than any other issue in this thesis, EU countries are split over what relationship with China they would like depending on the nature of their economies. EU countries preferences over trade with China are less aligned than in most other areas relating to the single market.

Fox and Godement (2009) argue that there are major differences between the attitudes of each EU state over both the political and economic stance that the EU should take towards China. Fox and Godement (2009) class European countries into four categories (see figure 16 below): "ideological free traders", including the UK, who most strongly oppose restrictions in trade but want to press China on political issues; "assertive industrialists", who want to stand-up to China on both economic

and political issues; “accommodating mercantilists”, who want trade barriers to protect their domestic interests; and “European followers”, who are happy to follow the rest of the EU. These differences in attitude make it difficult to come to a common position.

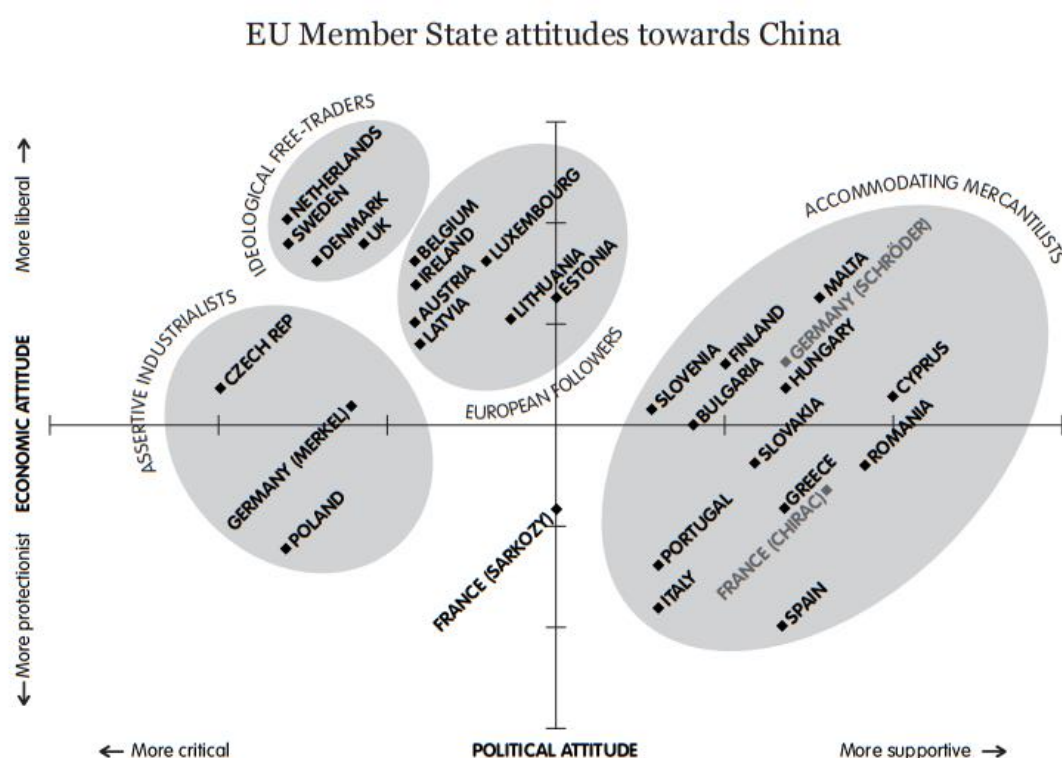


Figure 16 - Differences in Attitudes towards China of EU Member States (Fox and Godement 2009). Used with permission from ECFR.

More recently, China’s assertiveness has made EU unity even harder. China have been accused of setting EU countries off against each other in order to weaken the EU’s power in negotiations. Although the ‘divide and rule’ approach is more apparent in investment, as will be explained in chapter six, it still applies to trade. The dispute over solar panels highlights this well (Chen 2015). In 2012, some German solar panel manufacturers were unhappy with the pricing of Chinese exports of solar panels and lobbied the European Commission to investigate the alleged Chinese dumping. After an investigation, the EU did impose tariffs before agreeing a settlement with China in July 2013 in order to avoid a trade war, which could have harmed other EU states. The outward pressure from China upon the EU and

member states was a stronger influence on the EU decision making than the domestic pressure from the solar panel manufacturers.

The dispute over solar panels reveals a number of things about the political economy of EU-China trade. First, there was a divide in the economic interests of Europe. While the German solar panel manufacturers lost out considerably due to Chinese dumping, the European buyers of solar panels would have benefitted from a cheap influx. This divide between buyers and sellers of manufactured goods is common, as the figure above illustrates. Second, European institutions are such that some decisions made by the Commission have to be approved by member states (*Wall Street Journal* 2013, 30<sup>th</sup> August). This would have been difficult for the Commission, given China's ability to pick-off individual national governments. Finally, this might explain the tensions between major European countries and the EU. As Li Chen (2015: 6) argues, "the growing trade relations of Member States with China weakened the Commission's role of representing an integrated EU in negotiations".

This is relevant to UK-China trading relations because it demonstrates the declining role of the European Commission and the increased role of national governments. If one was to compare the 'bra wars' episode in 2005, as outlined in chapter three, with the solar panels dispute in 2012, it can be seen that the European Commission was far more assertive in 2005 than in 2012. The European Commission is the executive arm of the EU and makes day-to-day decisions about EU business (Nugent and Rhinard 2015). What the European Commission cannot do effectively is to mediate between EU states that disagree when there is not an already agreed position. Therefore as EU member states become more fragmented, the role of the European Commission declines. The progress on trade is now so slow that the European Commission (2013) has since prioritised the investment deal over a trade deal.

#### **5.4.3 Failure to Agree to Trade Deal**

Trade between the EU and China is based around the 1985 EU-China Trade and Cooperation Agreement (Fox and Godement 2009: 19). This agreement sets out cooperation on a broad range of issues, including according each other most-

favoured-nation treatment. This agreement has since been supplemented by smaller agreements covering specific policy areas (SIA 2007: 8). Dialogues on trade, such as the High-Level Economic and Trade Dialogues since 2008, have taken place and cover issues ranging from market access to anti-dumping. Agreements reached between the EU and China, including the Comprehensive Partnership in 2001 and the Comprehensive Strategic Partnership in 2003 were useful in collaborating on various projects but have not reduced trade barriers.

These agreements are far from free trade agreements (FTA) and substantial barriers to trade continue. Lu et al (2014) group the various trade barriers into tariff and non-tariff barriers. Tariff barriers include anti-dumping duties and discriminatory duties, which are used by both the EU and China. Non-tariff barriers are more significant. The EU's non-tariff barriers towards China include technical barriers, such as health and safety legislation (eg European Commission, decision 2002/994/EC; Food Standards Agency website); the arm sales ban; subsidies, particularly on agriculture; and export restrictions on high-tech products. China's non-tariff barriers include subsidies and export tax rebates; license regulations; non-transparent trade rules; and dumping. This is a long list, showing that both the EU and China have considerable trade barriers, so both sides contribute to the unfree trade.

Despite this, most of the grievances of unfair trade come from the EU side, and two particular problems are dumping and intellectual property. The European Commission (website) says: "A non-EU company is 'dumping' if it exports a product to the EU at a price lower than the normal value of the product". Dumping has been an issue for decades, with the first EU anti-dumping measures on China introduced in 1997 (Algieri 2002). Dumping is more likely to be a concern of either the "rising mercantilists" or the "assertive industrialists", given that it is their economies that are most undermined by Chinese dumping (Fox and Godement 2009). The UK government have been less concerned about it than other countries; the word 'dumping' does not appear in any of the China-UK Economic and Financial Dialogue Meeting papers up to 2015 (China-UK EFD 2008-2015). China opposes EU anti-dumping measures strongly and has retaliated by imposing its own anti-dumping measures (European Parliament 2016).

Another EU grievance over trade with China was over intellectual property. Wyzycka and Hasmath (2017: 549) describe the infringement of intellectual property as being “the EU’s primary concern in China” and “a major trade irritant” because of the damage it does to EU exports and brands. Europol (2015: 4) describe China as “a major source” of counterfeit goods, and a European Commission (2013) report said that 72% of the value of suspected Intellectual Property rights-infringing goods detained at EU borders came from China. This is perhaps unsurprising, given that so many legitimate goods also come from China, though is still a high proportion. The EU are not the only bloc to have an issue with China’s approach to intellectual property: the US has similar issues, and President Trump has even called it one of the “greatest thefts in the history of the world” (ABC News 2017, 9<sup>th</sup> November). Despite China’s purported attempts to tackle counterfeit production (Europol 2015: 4), it still remains a major problem for the EU.

The obvious liberal solution for these trade barriers would be a more comprehensive trade deal, however attempts at this have been unsuccessful. President Xi actively promoted an EU-China free trade agreement in a visit to Europe in March 2014, presumably in response to the negotiations on the Transatlantic Trade and Investment Partnership, which would link the EU and the US, and the Trans Pacific Partnership, which would link the US with a number of East Asian countries excluding China (Bendini and Barone 2015). While the UK has been supportive of a deal (China-UK EFD 2014; 2015), no deal has come about. The negotiations have been “going nowhere” and it is difficult to see how an agreement could be reached (Interview with MEP 2017).

There are two main reasons why a FTA between the EU and China has not been forthcoming. The first reason is that the divisions between EU countries mean that the EU has not had a coherent negotiating position (Interview with MEP 2017). As explained above, different EU states have different preferences that cannot be easily reconciled. This is particularly important given the structure of negotiating trade agreements – the European Council authorises the European Commission initially to start negotiating a trade agreement, then the final agreement has to be approved by both the European Council and the European Parliament (European Commission 2012). If the trade agreement covers areas that are the competence of member

states, then the agreement must be ratified by each state in addition. This process creates a large number of veto points, which could be used by a member state government that believes they are losing out. There would also be the potential for China to use its relationships with individual countries to try and influence the deal, as China has done with investment (Meunier 2014a; 2014b; 2014c).

The European Commission understandably did not want to draw attention to divisions between member states. However, there are several signs of this pressure on the Commission, aside from the economic forecasting (eg CEPS 2016: 269). During the 'bra wars' episode, EU Trade Commissioner Peter Mandelson (2005) acknowledged the difficulty for member states, who would have to approve the deal, and said he was "in close contact" with them. Privately, the Commission would blame member states for pushing for stronger anti-dumping policies towards China if questions were raised on their merits (Dreyer and Erixon 2008: 8). In 2009, Peter Mandelson warned member states not to hold up giving China Market Economy Status, reflecting the importance of member states (Willis 2009). This provides some evidence that member states are at the forefront of the Commission's mind when dealing with China.

The second is that the Chinese government have not had an incentive to agree a FTA when China already has strong access to the EU market. Fox and Godement (2009: 47) argue: "China has little to ask from the EU, since the European market in trade, services and investment is more open than that of any other major region". From a Chinese perspective, the EU is not a priority area for them and putting diplomatic resources into an EU FTA would be of limited use. The Chinese know that there is relatively little to gain from an FTA, and that the EU would find it difficult to agree to one anyway, given the coordination problems that exist. Fox and Godement (2009: 47) argue that "free-trade ideology weakens EU power" and ironically reduces the chance of freer trade.

An EU Commission (2020) overview of trade negotiations document states:

"Separate negotiations with China for an upgrade of the 1985 Trade and Economic Cooperation Agreement were launched in 2007 but

have been stalled since 2011 due to divergences between the mandates and expectations of the parties.”

As Zhang (2011: 3-4) argues, there were different expectations with regard to China’s international role and development: the EU wants an ambitious free trade agreement in which China could develop in accordance with the European model and take on greater global responsibility; China wants greater respect for its economic model. On the four-level game model, this represents the lack of a win-set between China and the EU.

The lack of a free trade agreement between the EU and China was used by the Leave campaign in the 2016 EU referendum to demonstrate the alleged illiberal nature of the EU. Vote Leave said “if we vote to leave the EU”:

“We’ll be free to trade with the whole world: The EU stops us signing our own trade deals with key allies like Australia or New Zealand, and growing economies like India, China or Brazil. We’ll be free to seize new opportunities which means more jobs.” (Vote Leave website)

The criticism of the EU that is clearly being made here is that the EU’s protectionism makes the UK unable to carry out a successful free trade agreement with China. They do not mention the disadvantages of the UK attempting to do a free trade agreement with China, not least the reduced negotiating power. Nonetheless, the point about the EU failing to agree a trade deal is valid.

Overall during the period, the failure to agree a trade deal meant that the legal structure of trade relations remained constant on the EU side. The changes of trade relations were down to the trade volumes increasing, which in turn was caused by China’s economic growth. This meant that member states diverged more pronouncedly than before, which reduced the role of the European Commission. The focus of EU-China economic dialogue is now on investment (European Commission 2013), rather than trade, which will be discussed in chapter six. However, the legal structure of the Chinese side changed significantly due to WTO accession.

## **5.5 Global Governance**

The World Trade Organisation plays an important role in regulating international trade (Bello 1996; Rose 2002; Subramanian and Wei 2007; Hoekman and Kostecki 2009). The WTO's role in UK-China relations comes indirectly through both China's 2001 accession, with the associated conditions, and in managing EU-China disputes since then. As argued in chapter three, China's accession into the WTO was an important event in recent global economic history. It was difficult for China to join the organisation, with China facing domestic opposition and having to make a deal with the US and EU (Liang 2002). The EU-China agreement was reached in May 2000 and was much easier than the US-China agreement, which was much tougher for China. Wei Liang (2002: 684) argues that US-China relations was one of the primary factors "in explaining the ebb and flow of the negotiation process" for China's WTO accession.

The EU-China agreement over WTO accession was simpler than the US-China agreement. For the EU, it was primarily an economic decision about gaining market access, something that the UK agreed with (UK Parliament 2001). Non-economic issues, such as human rights, were not considered (Zimmermann 2007: 820). The broad EU-China agreement was that China would gain most favoured nation status in exchange for lowering trade barriers and committing itself to multinational rules, such as non-discrimination (Farnell and Irwin Crookes 2016: 23). In this, Europe would benefit both from being able to export to and invest in China, and receive cheap, Chinese imports. The final issue that was agreed between the EU and China was that China would allow 51% foreign ownership of telephone networks and insurance companies (Liang 2002: 711). The EU remained unified during the negotiation, with the EU Commission given freedom to manoeuvre (Zimmermann 2007: 821).

Economically, China's WTO accession made a big difference. China modified more than 2,300 national laws and 190,000 local laws and regulations in order to comply with the accession agreement (Wang 2011). As well as regulatory changes, WTO compliance "provided the opportunity for China to promote and diffuse WTO norms



and rules in her trading practices” (He and Sappideen 2009: 871). China’s trade with the rest of the world increased substantially as a result of the reduced trade barriers. From 2001 to 2008, China’s total imports and exports increased from \$510 billion to \$2.5 trillion, representing a five-fold increase in seven years (Pan 2015: 745). China’s exports to the UK rose from £5 billion to £30.6 billion in the period 2000-2010 (House of Commons Library 2012).

However, the increase in trade flows has not been the only impact of China joining the WTO. WTO membership ties China to the WTO trading system, a central pillar of which is the dispute settlement system, which allows countries to be challenged if they are believed to break WTO rules. William Davey (2005: 209) has argued that countries demonstrate confidence in the dispute settlement system by using it; since 1995, over 500 disputes have been brought to the WTO (WTO website). Having a settlement system is necessary to enforce the rules and give confidence to governments and businesses (Maggi and Rodriguez-Clare 2007). The settlement dispute system has been used both by China and against China.

There were eleven cases between the EU and China brought to the WTO until 2015 (WTO website). Of these four have been complaints about the EU, and seven complaints about China. China’s four cases against the EU have alleged EU protectionism on specific poultry meat, renewable energy generation, iron or steel fasteners and footwear. All four cases were decided in China’s favour, and the EU agreed to comply with the WTO ruling. The seven cases brought by the EU against China also covered a wide range of issues, including automobile parts, raw materials, X-ray equipment and rare earths. Like the EU, China also respected the rulings made by the WTO; China either complied with the rulings made in full or reached an agreement with the EU.

This empirical evidence fits with the existing literature on China’s high level of compliance with the WTO, which shows that China has a high level of compliance with WTO. Zhang and Li (2014: 144) find that (as of April 2013) China had fully complied with all but one of the rulings in a timely manner, and resolved nine additional disputes through mutually agreed solutions. This record shows a higher degree of compliance than other large economies, such as the United States. This

record of compliance provides evidence that China are adapting to the liberal international trading system.

However, there may be other reasons why China have complied with WTO rulings in the period 2001-2015. Many scholars and journalists argue that China is a threat to the West (eg Gertz 2000; Mearshiemer 2006; Kaplan 2005). Scott and Wilkinson (2013) argue that China's compliance with WTO rulings means there is no evidence for this 'China threat' argument, but actually evidence for China keeping the status-quo. However, during this period China have also been lobbying hard to gain Market Economy Status (MES) in the WTO (Urdinez and Masiero 2015), which would make it harder for other countries to complain about dumping. Many countries, including the EU, have refused to grant China MES (Remond 2007). It is plausible that China's compliance with WTO rulings is linked to its desire to gain MES, and so China is waiting until it is firmly established in the WTO before being assertive.

One of the criticisms that has been made of the WTO is that it focused on purely economic issues, and ignores other relevant issues such as the environment and labour rights (eg Petersmann 2000; Charnovitz 2014). It is understandable though that the WTO has chosen not to embroil itself in "issues in which it has neither the technical ability nor the political legitimacy to act effectively" (Rollo and Winters 2000: 562). There are however, other international organisations which cover these issues and therefore affect global trade. The ILO works on labour standards issues worldwide and has been included in some trade agreements (Alston 2004), though not between the EU and China. The work done by the ILO in improving working conditions would indirectly affect trading relationships.

More important is environmental issues. There are a number of UN agencies that work on environmental governance, including the United Nations Environment Program, the United Nations Commission on Sustainable Development, the World Environment Organisation and the International Council for Local Environmental Initiatives. The most important initiative is Multilateral Environmental Agreements (MEAs), and both the EU and China have signed them. MEAs are more fragmented and work on a more issue-by-issue basis than international institutions, but still carry some force (Eckersley 2004). The EU is party to thirty-three MEAs, while China is

party to fifteen (MEA website). Zhao and Ortolano (2003) argue that China has a high level of compliance with MEAs because of its “desire to appear as a responsible and co-operative actor in solving global environmental problems”. This demonstrates how international organisations can change China on environmental issues, which then have an impact upon trade.

## **5.6 Bilateral Game**

Having analysed the domestic games of both the UK and China, the EU game and international organisations, this section will attempt to put it all together into the bilateral game. This is perhaps the least significant bilateral game because the UK has less control over trade policy than it does with human rights dialogue, investment policy or finance. Since trade policy is determined at EU level, there is very little that the UK could do unilaterally to change the systems in which the UK and China trade with each other. Nonetheless, there are two actions that the two countries take to promote trade: firstly, numerous trade visits, and secondly economic and financial dialogue.

As set-out in chapter three, there have been numerous visits made between the UK and China during the 1997-2015 period. Every single one of these bilateral meetings has focused on trade in some respect, though the later meetings also focus on investment and finance. Tony Blair said on a visit to Beijing in 2003 that he aimed to increase the UK’s trade with China by over 50% “within the next few years” (*Guardian* 2003, 21<sup>st</sup> July). During Xi’s 2015 visit to the UK, numerous trade deals were signed including a healthcare deal worth £2 billion and a retail deal worth £1 billion (UK Government 2015, 20<sup>th</sup> October). These visits are one way that the UK government can use its political influence to assist private businesses, as explained in the UK game above.

In addition, since 2008 the UK and China have engaged in economic and financial dialogue, where trade issues are discussed. Since trade cannot be directly negotiated between the two countries, most of the agreements reached on trade are general and vague. After the first meeting in April 2008 in Beijing, British Chancellor

Alistair Darling and Chinese vice premier Wang Qishan reiterated their commitment to economic openness and continued strong trade relations (*China Daily* 2008, 16<sup>th</sup> April), and the meeting minutes expressed the UK and China's "shared belief that open markets and free trade lie at the heart of our economic prosperity" (China-UK EFD 2008: 1). In the second China-UK EFD (2009: 3), the two countries expressed "full agreement on the advantages of maintaining free trade". In the third China-UK EFD (2010: 3), "both sides agreed to further promote bilateral trade". None of these statements are particularly meaningful given China's lack of market economy and the EU's trade barriers.

Some of the trade-related agreements reached between the UK and China relate to specific issues or projects. The two countries discussed and welcomed the bilateral Double Taxation Agreement (China-UK EFD 2013: 3). The two countries agreed to set-up a high-level UK-China dialogue on intellectual property to "understand each other's IP policies and concerns" (China-UK EFD 2011: 4), and to "enhance attention to and understanding of each other's trademarks systems" (China-UK EFD 2014: 3). The UK and China have also worked together on a sustainable cities initiative, which aims to use trade and investment to promote environmentally-sustainable urban development in four Chinese cities (China-UK EFD 2011: 4). They also cooperated on improving the UK's engagement with the Shanghai Free Trade Zone (China-UK EFD 2013: 5).

Finally, some of the agreed policy outcomes discussed in the bilateral game relate to the UK's position in influencing the EU's position. The UK's support for China gaining market economy status was affirmed in 2011 and 2013. In 2014, the UK and China affirm their commitment to "an ambitious and comprehensive EU-China free trade agreement, in accordance with the EU-China 2020 Strategic Agenda" (China-UK EFD 2014: 3). The free trade agreement is more long-term, but both sides agreed to "a joint feasibility study on an EU-China trade agreement as early as possible when conditions are right". Both countries also approved the China-EU Smart and Secure Trade Lane pilot project, which aims to improve supply chain security between China and the EU (China-UK EFD 2013: 4).

This trawl through EFD documents backs up Fox and Godement's (2009) analysis that classifies the UK as an "ideological free trader". The UK is much more supportive of free trade with China than the median voice within the EU. This is because of the nature of the UK economy being focused on the financial sector as opposed to the manufacturing sector, which is true of other EU countries. This supports the liberal view used in this thesis that states are rational and pursue their economic interests, as determined by their domestic game. The manufacturing sector does badly in the UK domestic game, whereas the financial sector is powerful, and this is reflected in the bilateral game and on the UK's influence upon the EU game.

## **5.7 Conclusion**

This chapter has argued that trade was the most significant issue in UK-China relations in the period. As China's economy has grown, its trade flows increase and its economy becomes more interdependent with the rest of the world, including with the UK. The UK's imports from China have increased throughout the period, due to the increase in Chinese products made overall but also helped by the growth in cheap credit that partly came from China. These goods benefitted the coastal provinces of China, where they generally came from, and British consumers, but there were also UK industries that lost out. This is exactly what liberal IPE (eg Rodrik 1997b) predicts would happen.

British exports to China have also increased, particularly since the financial crisis. The UK government have supported private businesses seeking to export to China for many years in expectation of strong growth in the Chinese market. But it was the growth of the middle-class in China in the 2010s that caused the sharpest rise in UK exports to China. The perception of British goods as being high-quality encouraged middle-class Chinese consumers to buy them, particularly if the Chinese-made alternative was low-quality. The increased market in China for British goods meant that trade was part of the economic deals that the Cameron government was trying to make.

The higher levels are vitally important. More than any other topic in this thesis, the EU matters because it has full legal competency on trade. The fragmentation of EU states, which became more pronounced as trade flows with China increased, meant that a substantial trade agreements with China has not been possible. The IO level did produce change, as China's WTO accession contributed towards China's significant increase in trade throughout the 2000s, although trade barriers still exist. The four-level game model is useful to identify the location of change, and how all the actors fit together.

Finally, this chapter demonstrates China's increasing assertiveness, which in trade terms amounts to China's increased buying power. This gives EU countries a greater incentive to pursue a strong relationship with China in the hope of being able to sell goods and services. The UK, constrained by EU as well as by the actions of other EU countries, has largely chosen to go along with quest for economic benefit from China. However, trade is not the only issue where China have been more assertive. Since the economic crisis, China's outward foreign direct investment has rocketed and the lure of Chinese investment was an even bigger factor than trade for EU countries wanting to do business with China. This is the topic of chapter six: investment.

# **Chapter 6: Investment**

## **6.1 Introduction**

The last chapter argued that the main cause of the changes in UK-China trade relations was the growth in China's economy. Prior to the financial crisis, China was the industrial powerhouse of the world and so the trading relationship was predominantly about cheap, Chinese goods being exported to the UK. As China's economy grew and its middle class expanded, China became a greater importer of goods, typically high-end, and the low-skill manufacturing moved to other countries. Trade was helped significantly by China's accession into the WTO in 2001, which lowered trade barriers, boosting its international exports including to the UK. They also exacerbated the different attitudes among EU countries to China, which were based upon different interests. The UK's service-focused economy favoured an EU policy position that was more supportive of free trade than most other EU countries. The UK did a small but limited amount to support trade without a major change to the EU-China legal framework of relations.

This chapter moves onto investment relations. Investment was the game changer in UK-China relations and was China's primary source of power after the economic crisis. China's large reserves gave it freedom to invest all around the world, while the UK needed inward investment at a time of austerity. This made the UK sensitive to the Chinese government's decision making, giving China power which it used to suppress human rights criticism and meetings with the Dalai Lama (Lee and Meunier 2015). This power was exaggerated by perceptions of China, and also the 'race to the bottom' between EU countries, particularly the UK, France and Germany. The 2012-13 freeze sent a strong signal to the UK about China's threats, although investment still rose during this period.

In a general sense, investment refers to the purchase of goods or shares with the expectation of future return. This chapter is mainly concerned with foreign direct investment (FDI) which Moran (2012) says:

“takes place when a corporation in one country establishes a business operation in another country, through setting up a new wholly owned affiliate, or acquiring a local company, or forming a joint venture in the host economy”.

FDI is an integral part of the modern global political economy and of supply chains for manufactured goods. The political impact of FDI depends on what sort of investment it is. In the UK, where there is a strong separation of ownership and control, the logic of liberalism is that ownership should not make a difference to how a company operates. On security-sensitive sectors, investment could make the host country reliant on the investor country, if the good or service could be withheld at enormous cost to the host country if there was ever a dispute (Moran 2009).

The thin constructivist perspective is also useful for analysing investment. Since investment requires an expectation of future return, and expectations are determined in part by norm dynamics (Seabrooke 2007: 373), norm dynamics are important for investment. As already mentioned, the perception of China as a rising superpower gives China extra power when investing in the UK. Norm dynamics are also useful in the other direction, as expectations of future growth make China a more attractive place to invest than current material capabilities imply. This chapter will argue that the majority of British businesses do badly in China because of warped expectations, as well as economic cultural differences between the UK and China.

One of the features of the UK-China investment relationship is, like with the trading relationship, that it is unequal in terms of access. The UK is far more open and accepting of foreign investment than China is meaning that China is able to invest in industries that the UK would not be able to invest in the Chinese economy. This lack of reciprocity hurts UK economic interests, because UK businesses are unable to make potentially profitable investments. It also contributes to a perception that China has something to hide, such as theft of intellectual property, and to a perception that China unfairly manipulates the global economic system for its own interests (Hanemann and Huotari 2018). This is a global problem that the UK is insufficiently powerful to stand-up to China independently on this, but it would require a global



response. Ultimately, the incoherence of the West in dealing with China has weakened the West's, and also the UK's, position.

The remainder of this chapter is structured in a similar way to the previous two chapters. In the next section, the investment statistics will be described and analysed, explaining some of the main patterns and the challenges with finding reliable data. The third section covers the UK game, emphasising the Cameron government's desire for inward investment from China during the period of austerity. The fourth section explains China's opening up to investment and stepping up of the 'Go Out' policy after the economic crisis. The fifth and sixth sections look at the EU's and IOs influence on investment relations, including the proposed EU-China investment treaty. This chapter then puts all the levels together by analysing the bilateral dialogue in the context of the other games, before offering concluding thoughts about UK-China investment relations.

## **6.2 Investment Statistics**

Understanding the quantitative data on investment is essential for understanding the politics of investment relations. In particular, it is important to recognise that investment has become a greater political issue since investment flows have increased. In many ways, this is not particularly surprising – if countries and individuals are rational and want to improve their economic wellbeing, then investment is going to be a greater political issue if it has a greater impact upon the economy. In the context of this project, investment flows increase significantly after the economic crisis, so the issue of investment becomes a greater issue politically.

A major problem with investment data is the statistical challenges in gaining accurate figures. It was argued in the introduction that, while every country has some statistical issues, China is notorious for poor-quality statistics. In addition to simply the size of the country, there can be political incentives to falsifying data (Shapiro 2018; Holz 2014). Investment data is no exception to this poor reputation, and the international nature of investment can make it difficult to keep track of and accurately classify all investment flows that come in or out of China. This is

complicated by Hong Kong, which is separate from China in international statistics but clearly has a close relationship with it. Sometimes China's outward investment travels through Hong Kong on the way to a third country; sometimes a foreign country's investment into China travels through Hong Kong (Chiang 2016). Between 1979 and 2004, Hong Kong accounted for 43% of China's cumulative inward FDI (Sung 2006), despite being a relatively small economy. It is difficult to know exactly how much this changes the data, but it is reasonable to assume the UK-China figure understates the true number.

Chinese investment data can also be distorted by a practice known as 'round-tripping'. This is where capital from China leaves and then re-enters, meaning that some of the Chinese inward investment shown in the statistics actually originates from China and is therefore not foreign investment. Round-tripping is used by Chinese people to avoid taxes or to get government benefits created to promote inward investment (Sutherland and Matthews 2009). It is often assumed to mainly apply to tax havens, particularly the Caribbean islands and Hong Kong, although the secretive nature of round-tripping means that the money could end up anywhere including in the UK. This could distort the overall investment data quite considerably, with most studies estimate round-tripping to be around a quarter of all Chinese inward investments in 1992 (Breslin 2007: 111). This provides a further problem with the investment statistics.

### **6.2.1 Investment Position**

Various different investment statistics are available that reveal different aspects of the UK-China investment relationship. One is to look at financial investments, which include not just direct investments in a specific company but also portfolio investments that have the aim of spreading risk. Finance is a stand-alone issue looked at in chapter seven, but for the purpose of investment, the UK's financial assets and liabilities are shown in figure 17 below. There is a clear upward trend in both assets and liabilities, and both appear to follow a similar pattern. UK assets in China were £4.5 billion in 1999 but have since increased more than twenty-fold to £103 billion in 2017 (ONS). UK Liabilities, which is Chinese assets in the UK,

increased from £4 billion in 1999 to £88 billion in 2017. In 2016, just under half of the UK financial assets in China were portfolio investments (see figure 18 below), so these are not FDI. This data highlights that UK-China investment is broader than FDI.



Figure 17 - UK Investment Position with China (ONS)

Type	Amount (£billions)
Direct	12.2
Portfolio	38.6
Other	29.4
Derivatives	3.0
Total	83.2

Figure 18 - Investment Type of UK Assets in China (ONS)

### 6.2.2 FDI Flows

FDI flows measure the “investment made by a firm or individual in one country into business interests located in another country” in a given year (Investopedia). A graph showing FDI flows between the UK and China are shown in figure 19 below. Several features of this data are apparent. First is that until 2014 UK outward FDI to China was higher than FDI in the opposite direction. Up until 2011, UK inward FDI from China is insignificant, only going above \$32 million in one year (2009). On the other hand, in 2014 and 2015, UK outward investment to China was negative, meaning that overall UK firms were pulling investments out of China. As argued below, this reflects a trend of greater China assertiveness and willingness to invest internationally.

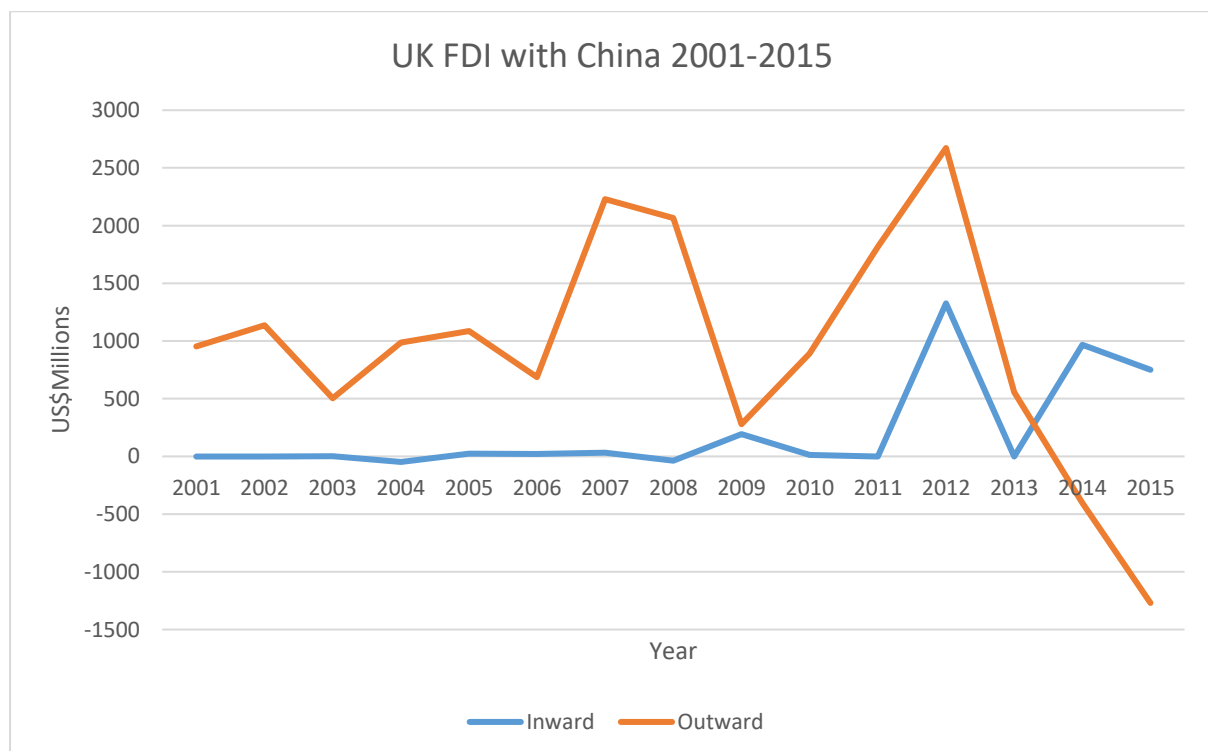


Figure 19 - UK-China FDI relations (ONS)

The second feature of the graph is that it looks ‘spiky’, so data points can vary from year-to-year. This is possible because if country received a large investment in one year, that could easily skew the data and results in a spike; indeed, it is possible that only one investment can do that given the relatively low level of FDI flows. The ONS

data has two data points that are unavailable because they are considered 'disclosive data' (inward investment in 2011 and 2013, both marked as 0) meaning that it is dominated by one transaction so that an individual company could be identified, which goes against ONS policies (ONS). This is different to trade data, which represents lots of smaller transactions rather than potentially a few very large investments.

### **6.2.3 Individual Investments**

Since the China to UK FDI flows are dominated by a small number of large investments, it is useful to look at the investments individually. Table 5 below shows the Chinese investments in UK companies worth over \$500 million dollars that have been made during the 1997-2015 period (American Enterprise Institute). There were twenty-two investments overall, in a range of sectors including energy, finance, real estate, agriculture, transport, utilities, clothing and metals. The investments are concentrated around the end of the period studied; there was no Chinese investment in the UK worth over \$500 million until November 2006, but there were nine such investments just in 2014 and 2015. Eight out of the twenty-two large investments are in real estate, more than any other industry.

Table 5 - Chinese Investments in UK companies 1997-2015 (American Enterprise Institute). Note that only investments worth over \$500 million are included.

Year	Month	Chinese Company Investing	Amount (in millions of US dollars)	Company holding	UK Company being invested in	Sector
2006	November	China Development Bank	800	1%	Anglo-American	Metals
2007	July	China Development Bank	3,040	3%	Barclays	Finance
2008	April	SAFE	2,010	1%	BP	Energy
2009	August	Sinochem	880	100%	Emerald Energy	Energy
2010	February	CIC	960	2%	Apax Finance	Finance
2011	January	CNPC	510	50%	INEOS Britain	Energy
2012	January	CIC	920	9%	Thames Water	Utilities
2012	February	Guangdong Nuclear Power and China Development Bank	990		Kalahari Minerals	Metals
2012	May	Bright Foods	1,940	60%	Weetabix	Agriculture
2012	July	Sinopec	1,500	49%	Talisman Energy	Energy
2012	October	CIC	730	10%	Heathrow Holding	Transport
2013	February	SAFE	840	40%	UPP Group	Real estate
2013	June	Dalian Wanda	1,090			Real estate
2014	January	Shanghai Greenland	980		Minerva	Real estate
2014	January	CIC	1,280		Blackstone	Real estate
2014	February	ICBC	690	60%	Standard Bank	Finance
2014	March	Shanghai Greenland	990		Commercial Estates Group	Real estate
2014	April	Sanpower	790	89%	House of Fraser	Other
2014	June	China Life	950	70%	Songbird	Real estate
2014	July	Legend	1,540	100%	Pizza Express	Agriculture
2015	April	State Construction Engineering	750		Dalian Wanda	Real estate
2015	October	CITIC	670	25%	Royal Albert Docks	Real estate

### **6.3 UK Game**

The first game is the UK game. The UK has historically been an open economy, and this applies to investment as it does to trade and finance (Hirst and Thompson 2000). Generally, the UK has been welcoming of foreign investment, and this has rarely been a political problem for British governments. The UK has also been relaxed, and even encouraging, of outward investment to grow British companies around the world. Applied to China, the UK benefits from investment relations in both directions, though of course different people benefit from different investments. Like with trade, the general UK government strategy has been to accept the benefits of globalisation but try to redistribute to compensate those who lose out. After 2013, the Cameron government activity courted Chinese investment after being cut out of diplomatic relations after the freeze. One of the reasons why Chinese investment was wanted was to balance the loss of investment caused by the economic crisis and austerity.

#### ***6.3.1 Outward Investment***

Since 1979, the UK government has not sought to control flows of British capital, including outward FDI, and this is a trend across most Western countries. The IPE literature has explained this trend in a number of ways. Goodman and Pauly (1993) argue that increasing globalisation meant that businesses were more mobile, reducing the usefulness of capital controls when businesses could just relocate. Chwioroth (2010) argues that changes in “capital ideas”, particularly in the IMF, led to the change in norms and a political choice to remove capital controls. Copley (2017) argues that the biggest reason for the UK change was the problems with stagflation in the 1970s.

This meant that capital controls were not in place during the 1997-2015 period and there was not any attempt by either major party to re-introduce them. The commitment to globalisation meant allowing companies to invest where they wanted,

even if it outside of the UK. Indeed, in some ways the UK government supported companies investing in China through the publicly-subsidised, quasi-private CBBC. As discussed in the previous chapter, the CBBC has a network of offices in China and lots of expertise of the Chinese market. Some of the advice it gave to businesses was how to best invest in China (CBBC website).

There are two types of investment that UK businesses could make in China: market-seeking investment and export-seeking investment. Franco et al (2008: 14) says market-seeking investment aims “to exploit a foreign market which is of some appeal to the firm, in particular by supplying the market of the host country, or that of adjacent ones, with goods and services”. As explained in the last chapter, the Chinese middle-class grew a lot, particularly in the 2010s, and that provided a significant opportunity for international businesses. Restrictions on exports to China meant that in some industries it was necessary to invest in China to be able to sell to the Chinese market. For example, tough restrictions on exporting cars to China from a foreign country meant that Jaguar Land Rover had to invest in a joint venture with the Chinese firm Chery Automobiles to be able to access the Chinese market (Zhang and Taylor 2001). Other Western car manufacturers, including Peugeot of France, Chrysler of the United States and Volkswagen of Germany, had similar joint ventures with Chinese companies to access the Chinese market.

The UK's market-seeking investment into China has not lived up to expectations and in many cases was disappointing. The Chinese market is more different to Western markets than UK businesses tend to realise, and UK goods are not as in demand by Chinese consumers as some predict. Tesco is an example of this, as they went into the Chinese market optimistic of success. In November 2010, then Tesco Asia Director Philip Clarke (2010) said that “China is...a meaningful part of our long-term growth”. In 2014 Tesco increased the number of China stores and described China as a “strategically important growth market” (Tesco PLC website). Ultimately, Tesco failed to understand the Chinese market and withdrew after losing £1.5 billion (Pendrous 2013; *Guardian* 2013, 9<sup>th</sup> August). This comes back to thin constructivist argument made in chapter two and how perceptions of China's market, whilst not being totally removed from the material reality, exaggerate the business opportunities that could be reasonably be taken.



The second type of investment in China is export-seeking investment, which could also be called efficiency-seeking investment (Franco et al 2008). This is where a UK company would invest in a Chinese factory in order to shift production to China. This benefits the company because goods can then be produced at a lower cost since labour costs are considerably lower. The goods can then be exported from China around the world, including back to the UK, to be sold with a higher profit margin. This outsourcing has similar domestic effects to trade, discussed in the previous chapter.

One example of a company that made an export-seeking investment in China is the footwear company Dr Martens. The internationally recognisable brand had started to struggle in the 1990s, so in 2002 the company made the decision to move all production where labour was cheaper (BBC News 2002, 24<sup>th</sup> October; *Guardian* 2002, 25<sup>th</sup> October; *Sydney Morning Herald* 2010). A thousand UK jobs were lost overall, which particularly impacted the town of Irthlingborough in Northamptonshire, where Dr Martens had been a community stakeholder. This is illustrated by the fate of the local football team, Rushden & Diamonds, which was owned by Max Griggs, owner of Dr Martens, until he sold it in 2005 (*Independent* 2005; BBC News 2011, 6<sup>th</sup> July). The club did well with a healthy fan base from the Dr Martens factory, reaching Division Two, then the third level of English football, in 2003 (Football Statistics Archive). After the factory closed down however, the club did badly; Rushden & Diamonds eventually went into administration in 2011 and the 6,500-capacity stadium Nene Park was finally demolished in 2017 (BBC News 2017, 27<sup>th</sup> February). After moving production to China, Dr Martens no longer had a stake in the town, and the town suffered as a result.

The case of Dr Martens demonstrates the winners and losers from outward investment to China were similar to that of trade and also that predicted by Rodrik (1997b). The thousand workers who lost their jobs were the obvious losers, as were their communities, as the workers were unable to compete internationally. The winners include the company owners, since the costs of production fell which contributed to the company becoming profitable again: in 2011, it made a profit of £15 million (*Financial Times* 2013). Consumers also benefitted from the company

continuing to operate, thus giving consumers the choice of buying Dr Martens shoes. These costs and benefits are unevenly spread, much like globalisation generally.

### **6.3.2 Attracting investment**

Investment is a component of GDP and improves the productive capacity of the economy. The position of successive UK governments can be summarised by George Osborne and Danny Alexander when they said “Britain at its best is a country that invests in the future” (HM Treasury 2013). FDI has similar benefits as domestic investment, the only difference being that a foreign company or government has ownership of the investment. Inward FDI tends to result in higher wages, and benefit the region being invested in (Girma et al 2001). Like with outward investment and with trade, inward investment produces winners and losers.

The strategy of New Labour and the Coalition was to embrace FDI in order to create wealth but then to try to redistribute it. Tony Blair made speeches simply assuming that inward FDI was a good thing (eg BBC News 2000, 14<sup>th</sup> August). Gordon Brown argued that 800,000 British jobs were created between 2000 and 2010 due to inward FDI (*The Telegraph* 2010, 21<sup>st</sup> Feb). The 2010 Conservative Party Manifesto promised “a series of measures to encourage Foreign Direct Investment into the UK” as part of a section to “encourage enterprise” (Conservative Party Manifesto 2010: 19). These quotations fit with the overall political economy model of embracing the benefits of globalisation and then redistributing.

Historically, the UK has been open to inward FDI and “over-internationalized”, and investment is a part of that (Hirst and Thompson 2000). The legal system is a strong attraction for foreign companies, since judges are independent of government and make decisions with a high degree of transparency and predictability based upon precedent (Clark 2010; Mahoney 2001). These strengths have meant that English law governs more international commercial contracts than any other legal system (Law Society 2007). In addition, the British public have been unconcerned by foreign owned companies investing in the UK. Capie et al (2004) argue that “foreign ownership of domestic firms is almost a non-issue in Britain”. The strong separation

of ownership and control in UK companies means that a company's operations normally do not change significantly when the owners change (Capie et al 2004).

One of the possible exceptions to this is the controversy over Japanese investment in the 1980s. The Nissan car factory in Tyne and Wear created the most controversy, with particular opposition from trade unions who argued that their members could be adversely affected (*Times* 1983; 1987). Nissan managed to agree a single-union clause, which meant that only one trade union was recognised – the Amalgamated Union of Engineering Workers – and that strikes were effectively ruled out (*Times* 1985). Ultimately however, the controversy went away and Japanese-owned factories, including the Nissan factory in Tyne and Wear, have remained in the UK. It may even have helped reassure the British public that foreign investment was not dangerous.

This raises the question of why Chinese investment was controversial – not just in the UK but across the West (eg Tingley et al 2015) – when foreign ownership of domestic firms is usually a non-issue. Around the time of President Xi's 2015 UK visit particularly, there was a lot of discussion about the political implications of Chinese investment, not usually seen of foreign investors. As discussed in the introduction and in chapter two, there is an increased wariness of China as it is perceived as an emerging superpower that threatens the liberal world order. China does not have the same political and economic values as the West does, and this is reflected in the lack of reciprocity – China, and Chinese companies, are able to invest in, compete in and own capital in the UK economy to a much greater extent than UK companies are able to in the Chinese market. In addition, there are two specific reasons why Chinese investment was criticised to a greater extent than foreign investors are normally: firstly, on security grounds, and secondly, on human rights grounds.

The first specific criticism was on security grounds. Nick Timothy (2015) argued that “the Government is selling our national security to China”. Some of the sectors that China invested in were sensitive to UK security, particularly the nuclear plant at Hinkley Point C. Timothy (2015) expressed concerns that “the Chinese could use their role to build weaknesses into computer systems which will allow them to shut down Britain's energy production at will”. It was reported that these concerns were

shared by security and intelligence experts (*Times* 2015), as well as by the opposition (*Guardian* 2015, 16<sup>th</sup> March). On the other hand, there may also be security risks with not building a new nuclear plant, given the importance of energy security (Hamilton 2010), an argument which was made by the government (BBC News 2017, 3<sup>rd</sup> July). Perhaps the more serious criticism of the deal was the value-for-money aspect, with a very critical National Audit Office (2017) report. However, this was more related to public financing than UK-China relations.

In addition to Hinkley Point, concern have also been raised over Huawei. Huawei is a Chinese telecommunications equipment company, which has since 2012 been the largest telecommunications equipment manufacturer in the world (*Economist* 2012). Huawei was actively courted into making “equipment and services that put it at the heart of Britain’s communications network”, which Timothy (2015) argued was controversial because both the US and Australia had blocked the company doing projects. Huawei gave up on the US market in 2013 as it struggled to get market share after a House Intelligence Committee Report discouraged businesses from partnering with Huawei (Tiezzi 2013). In 2012, the Australian government blocked Huawei from building a US\$ 38 billion high-speed broadband network over fears of cyber-attacks originating in China (Haveman and Vochtello 2016: 88). Similar concerns over espionage and cyber-attacks could be raised over Huawei’s role in the UK’s communication network.

Projects with security concerns only cover a small part of the total stock of Chinese investments in the UK, so it should not be seen as a concern for every single Chinese investment. The concerns that have been raised are legitimate however, and there is the potential that these concerns could be exploited were the UK and China ever at war, or had extremely tense relations. In an uncertain world where the future is hard to predict, it is unwise to give sensitive jobs to countries that have not historically been strong allies. The US approach, which involve detailed examination of investments that threaten national security through the Committee on Foreign Investment in the United States (Masters and McBride 2018), is a better approach. While the UK does not have direct security competition with China in the way that the US and Australia do, it is unwise to leave security exposed to a non-ally (Larson and Marchick 2006).

The second main criticism of Chinese investment in the UK is that it ignores China's human rights record. In response to Xi's 2015 visit to the UK, the Dalai Lama said: "Money, money, money. That's what this is about. Where is morality?" (Spectator 2015). The Dalai Lama's argument here is that the Cameron government prioritised trade and investment deals over pressure on human rights and Tibet, and that this prioritisation was immoral. During the same visit, human rights groups such as Amnesty International UK also made similar arguments, holding banners and placards with slogans including "people before profit" and "rights over revenue" (Amnesty International UK press release 2015).

The issue of human rights has already been discussed so will only be covered here briefly. Chinese investment is unlikely to undermine human rights or labour rights in the UK, since the stock of Chinese investment is low and UK political institutions are robust. The balance between promoting human rights in China on one hand and trade and investment relations in the other is a very difficult balance to get right. The Chinese government's dislike of public human rights criticism can be shown not only through statements made, but also by the Dalai Lama effect, which occurs when Chinese FDI into a country falls when the leaders of that country meet with the Dalai Lama (Lee and Meunier 2015). This forces other country's governments to decide between making statements on human rights or stronger trade and investment relations. The way of overcoming this is to have a more unified approach to China among the West.

### Government Support for FDI Inflows

The UK government actively supports inward foreign direct investment using many of the same organisations that it uses to promote trade. One of the main roles of UKTI was to promote inward investment, which it did through networking and publishing guides on why foreign companies should invest in the UK (eg UKTI 2013). The CBBC have also played a role in promoting inward FDI, through providing information and networking opportunities (CBBC website). One case study that the CBBC have advertised (CBBC website, Attracting Chinese Investment: Leeds and

Partners) is the publicly-funded investment agency Leeds and Partners, whose mission is to attract trade and investment to the city of Leeds. They worked with the CBBC to network during a twelve-day business tour of six cities, which resulted in numerous leads, which they later chased up to increase investment into Leeds.

### *The Importance of Attracting Investment in Times of Economic Crisis and Austerity*

UK government was particularly keen to attract Chinese investment after the financial crisis. Between 2007 and 2009, business investment fell by 20% (ONS), caused by the recession and the economic uncertainty (Smietanka et al 2018). This decline in private investment was accompanied, a few years later, by a decline in public investment because of austerity. Public sector net investment fell from £53.5 billion in 2008-09 to £30.7 billion in 2013-14 (HM Treasury 2018: 47). This fall in investment – both public and private – meant that the UK became more dependent on foreign investment. Lower levels of investment in the UK economy meant that foreign investment became more valuable, as worthwhile investment projects were prevented from happening. In the early 2010s, the economic recovery was also fragile, and international investment would have given a boost to GDP. It is in this context that the Cameron government's drive towards Chinese investment occurs. Increased economic desperation pushed economic relations ahead of non-economic concerns, such as human rights.

This links to the bilateral game below, when Cameron and Osborne put a lot of effort into attracting investment from China. They avoided the issue of human rights as to not offend the Chinese government, and made several visits to China, bringing large delegations as outlined in chapter three. Other countries, including France and Germany, were doing this too so the UK was having to compete with them for investment. Much of the rationale for this was future orientated; as table 6 below shows, even in 2015 – the high point of the period – China's OFDI flows made up less than 2% of the UK's overall inward FDI, and less than Ireland, Singapore and Canada (ONS). Thus, the focus on China was based upon the norm of future growth rather than China's actual economic capability. Once again, this is best explained by

the social construction of China as an emerging superpower, as argued in chapter two, rather than by its current material capabilities.

*Table 6 - 2015 FDI flows into UK from selected countries (ONS)*

<b>Country</b>	<b>2015 OFDI into UK (£million)</b>
USA	21113
Singapore	3754
Canada	3527
Japan	1718
Ireland	681
China	460
Denmark	451

## **6.4 China Game**

The other domestic game is the Chinese game. Like with trade, there are winners and losers from opening up China to the global economy. The Chinese government however, calculated that the benefits would outweigh the costs which is why they agreed to join the WTO in 2001, which made it easier for foreign companies to invest in China. The Chinese investment game also includes its build-up of reserves in the lead up to the financial crisis, which China then begins to invest internationally. There are a number of domestic rationale for the Chinese government choosing to invest abroad, and these rationale affect the patterns of Chinese outward investment.

### ***6.4.1 Inward Investment***

As China has gradually opened up its economy to rest of the world, it has become more welcoming to inward FDI, resulting in higher inflows (see table 7 below). Chen (2009) divides the recent history of FDI inflows into three periods. Firstly, there was

the experimental phase between 1979 and 1991, during which Special Economic Zones were set-up but inward investment was still quite restrictive. The second period was boom phase between 1992 and 2001, between Deng's southern tour and WTO accession. Inward FDI flows quadrupled between 1992 and 1997 from \$11 billion to \$44 billion (World Bank). Breslin (2007: 86-87) argues that the vast majority of inward investments in this period were made for the purpose of creating exports for external markets, particularly Western markets. This had the advantage of providing additional jobs without competing with domestic industry and making urban workers worse off. With the exception of a two-year interruption caused by the Asian financial crisis (Chen 2009: 102), the strategy succeeded in increasing FDI inflows.

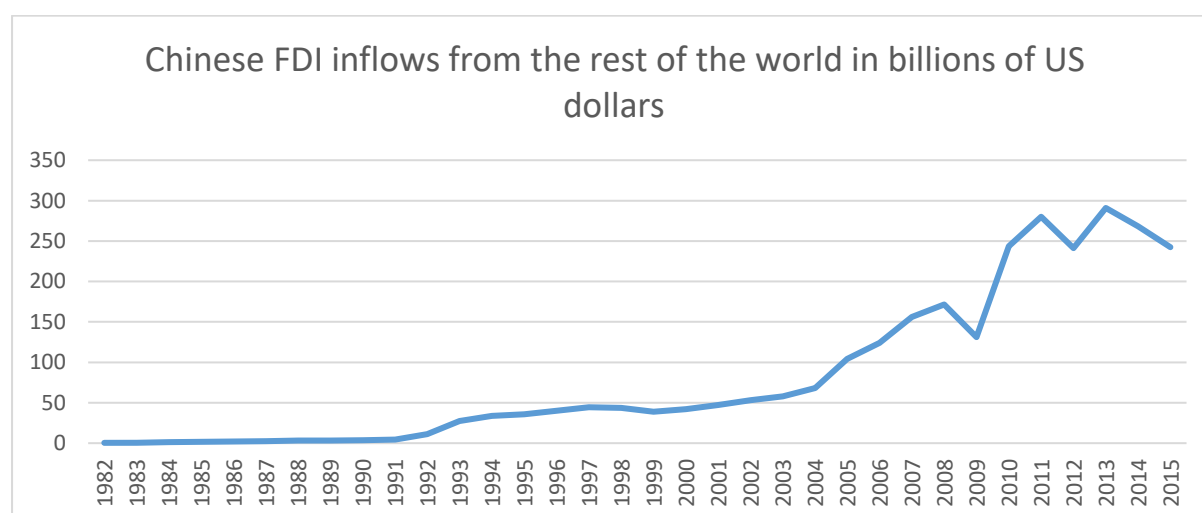


Table 7 - Chinese FDI Inflows (World Bank data)

The third and final period occurred after WTO entry in 2001. The liberalisation of trade had an indirect effect on investment by making Chinese markets more accessible to foreign exporters. There was also a liberalisation in investment policy, which gave foreign firms more rights to invest in China. The exact rules depended on the industry, but for most, foreign ownership of 50% of the company was allowed (Hong Kong Monetary Authority 2002: 12). Some sectors, including hotels and reinsurance, allowed 100% foreign ownership after WTO accession. The allowed activities that businesses were permitted to engage in increased also.



This economic liberalisation associated with WTO accession led to an increase in inward FDI flows from the rest of the world. FDI inflows increased more than five-fold between 2002 and 2013 (World Bank), although for reasons stated above, the investment flows graph is more 'spiky' than the trade graph. The increase in FDI inflows has meant that the number of foreign owned businesses in China, both Wholly Foreign-Owned Enterprises (WFOEs) and International Joint Ventures (IJVs), has increased both in absolute terms and as a proportion of total FDI inflows (Puck et al 2009).

These global trends are also applicable to the UK, as FDI flows from the UK to China increased after China's WTO accession. Figure 20 below shows an upward trend, and a structural break around the millennium (OECD). Before 1999, UK FDI to China had only gone above £100 million in one year, 1996. Between 2002 and 2012, UK FDI flows to China averaged £670 million. Thus the UK fits the global trends described above. In the overall scheme of China's inward investment however, the UK is of small significance. Figure 21 below shows that the significance of the UK in China's inward investment expressed in proportionate terms has been declining since 1999, where it peaked at 2.5%. These figures include Hong Kong as a major sender of FDI to China, and the UK's significance would increase were Hong Kong to be discounted, but that does not affect the overall trend.

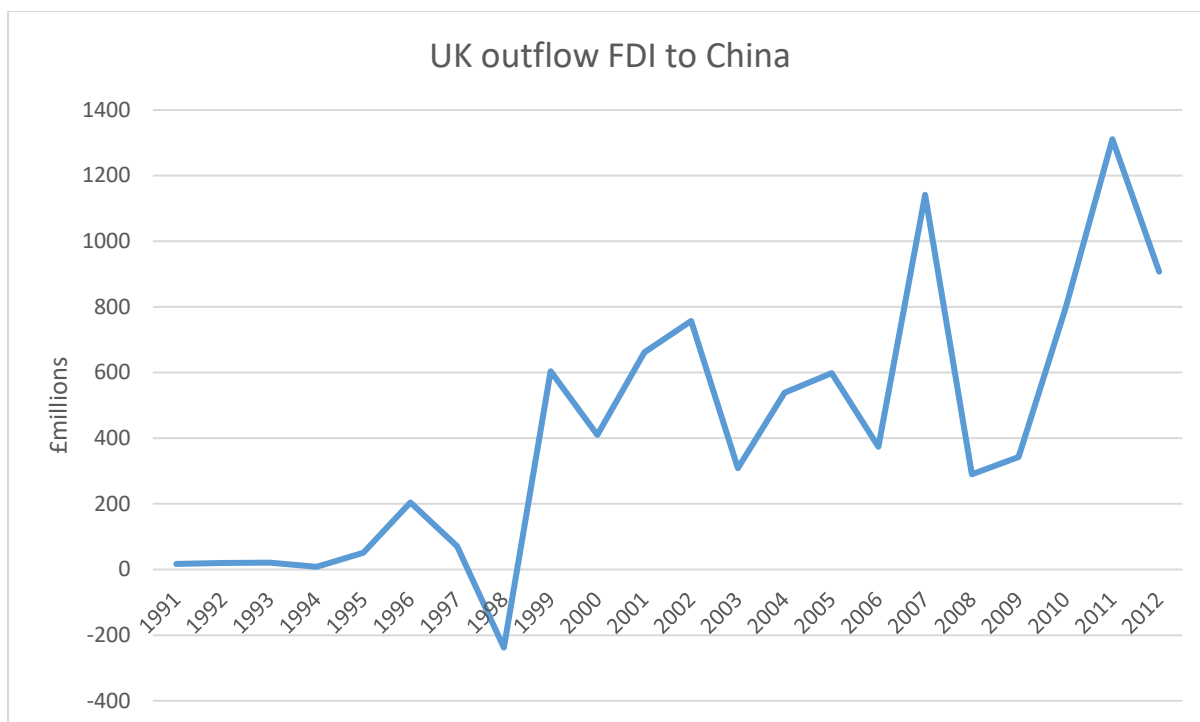


Figure 20 - UK FDI flows to China (OECD)

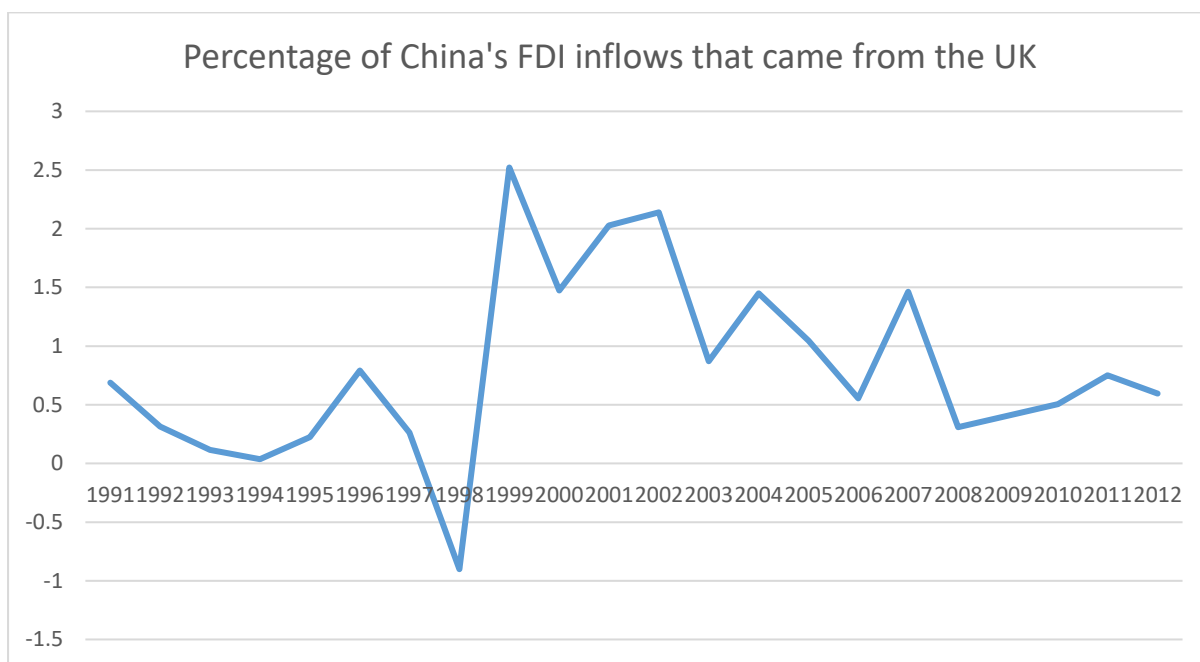


Figure 21 - Percentage of Chinese FDI inflows that came from the UK (author's own calculation based on data from OECD; UNCTAD)

These FDI inflows, from the UK and other countries, benefitted China in several ways. Investment often brought more advanced technology and management skills that makes the Chinese economy more efficient, particularly towards the end of the period (Liu and Daly 2011: 15). Wang and Wang (2015) find that investment improves the financial conditions of companies, since Western firms tended to have lower leverage ratios (debt as a proportion of total assets), and higher liquidity ratios (the difference between assets and liabilities as a proportion of total assets). This makes firms more stable as they are relying on internal capital rather than debt. Foreign company ownership also boosts output, employment and staff salaries. If foreign-owned companies were to leave China, many of their jobs would too.

However, significant barriers to investment in China remain. While in many sectors China has opened up on a macro-level, when the details and nuances are considered it is less open than it appears. Corruption continued to be a problem in the Chinese economy, with businesses that were politically well connected getting a substantial advantage because of more favourable treatment from government (Fan et al 2009). In addition, some of the subtler, more detailed laws amount to unfair practice that hurts foreign-owned businesses. These include denying access to domestic marketing channels, discriminating against foreign-owned businesses when allocating public contracts, giving domestically-owned firms preferential access to land and spending government money on the research and development side of domestically-owned businesses (Breslin 2007: 100). In 2007, the Chinese government passed an anti-monopoly law that when enforced disproportionately targeted foreign-owned businesses that were gaining market power (Geer 2016). These factors make it more difficult for UK businesses to successfully invest in China.

The strategy on inward investment pursued by the Chinese government therefore, is to encourage inward investment when it helps the economy but keep it under control. As argued in chapter two, the Chinese government's main source of legitimacy is economic growth. The way that China's domestic game has been played is that the government calculated that economic liberalisation would lead to economic growth, and that growth would maintain legitimacy in the government. Attracting inward investment, which created jobs, increased salaries and boosted the volume of

exports, was a major part of that. The UK played a role in investing in China alongside many other countries, which the Chinese government hoped would contribute towards these objectives.

It is worth pointing out at this stage that the perception of China's growth benefits China because of the increase in inward investment it provides. Several notable forecasts from advisory groups show China continuing to grow, overtaking the US in terms of total GDP and becoming the engine for growth in East Asia (eg Da Cunha 1998; Goldman Sachs 2003; PWC 2016). Business advice on investing in China often list high growth rates as a major positive in investing in China (eg Deloitte 2016; Kuepper 2019). This perception encourages businesses to invest in China, which boosts economic growth, and may indeed end up making predictions of Chinese growth a self-fulfilling prophesy. This demonstrates the dialectic relationship between perceptions and material reality discussed in chapter two, which thin constructivism accounts for well.

#### **6.4.2 Outward Investment**

Arguably the most significant trend in China's economic engagement with the rest of the world after the economic crisis was the exponential increase in outward FDI. Prior to the 2000s, China experimented with outward investment and invested into Hong Kong (Buckley et al 2010; Chan 1995), but outward investment was insignificant. Between 2007 and 2015 however, the total value of China's outward FDI flows increased from \$26.5 billion, equivalent to 1.22% share of the global total, to \$127.6 billion and 8.65% (Wang and Zhao 2017; UNCTAD 2014). China's 'Go Out' policy, which aimed to take advantage of the global economy (Salidjanova 2011), was stepped up after the financial crisis, boosting investment all around the world including to the UK. There were five central motivations for the increase in Chinese outward investment.

The first motivation was to have greater control over natural resources. China's growing economy and population has meant that domestic demand for natural resource had grown, and will continue to grow, particularly on oil and food (Alden

2005; Brautigam 2015; Smith 2015) China's leaders developed international investment relationships to meet this domestic demand (Breslin 2012). This is more directly relevant to Africa than the UK, but is still relevant because the interconnectedness of the global economy and Britain's historic influence in Africa. When the China Development Bank invested in Barclays in 2007, Barclays Chief Executive Bob Diamond said that China was interested in strengthening their banking links with East Africa (*Guardian* 2007, 23<sup>rd</sup> July). Barclays have over 1000 branches in East Africa and have had a strong presence in African finance since the 1920s (Cottrell 1994: 1198). China Development Bank and Barclays later signed a Memorandum of Understandings pledging to work together in East Africa (ABSA press release 2014).

Secondly, hyper-competition at home meant that Chinese companies needed somewhere else to expand. Wong and Chan (2003) argue that China has become a "capital-surplus economy". Large inward financial flows and a high savings rate has meant that China has a large amount of capital in its economy. This cheap finance, along with a state-controlled financial system, means that some industries have problems with overcapacity and oversupply because too many factories have been built (Overholt 2005). This hyper-competition makes investing overseas, including in the UK, more attractive because the domestic investment market was to a large extent saturated.

Closely related to the second motivation, the third motivation is to diversify China's investment portfolio away from US treasury bonds. By 2009, China has accumulated \$2.4 trillion in foreign-exchange reserves, which accounts for just under a third of the global total (Hu 2010). Among investment professionals, it is widely agreed that diversification is a necessary strategy to minimise risk, and for an international investor this means investing in different parts of the world (Doukas and Lang 2003; Lioudis 2018). The financial crisis highlighted the vulnerabilities in the US and the need to invest in other countries. The Chinese government set-up the CIC specifically to diversify its portfolio of worldwide investments (CIC website; Balding and Chasagner 2017), and similar roles are also performed by the State Administration of Foreign Exchange, China Development Bank, CITIC, Legend

Holdings and China Life (Hu 2010). Much of the Chinese investment in the UK was portfolio investments, such as property (BBC News 2015, 20<sup>th</sup> October).

Fourthly, Chinese outward FDI can lead to technology transfer, and improve domestic productivity (eg Wei 1995; Whalley and Xian 2010). Investing in or merging with a Western company with a higher level of technology allows a Chinese firm to “leapfrog” stages of development as the firm can then make use of the better technology (Salidjanova 2011: 8). This can be seen through Sinopec’s interactions with the British oil and gas company BP, a leader in exploration technology (BP Annual Report 2016). In 2001 BP and Sinopec formed a joint venture, SECCO, which was expanded in 2005 into Chongqing (Sinopec website; *China Daily* 2005). SAFE invested over \$2 billion in BP in 2008 (American Enterprise Institute), before BP and Sinopec announced another joint-venture, this time in Singapore. In the 2010s, China used FDI as a way to acquire foreign technology, something the US have been critical of (O’Connor 2019).

Finally, investing abroad means that China can acquire brand names. Brand names are important in distinguishing a company’s product from competitors, and can be a valuable intangible asset. Gao et al (2003) argue that the lack of marketing skills is the “biggest obstacle” for Chinese companies to create and sustain brands in foreign countries. The UK has many internationally successful brands that China have acquired, particularly in the food industry. In 2012, Bright Foods invested in Weetabix, and in 2014, Hony Capital invested in Pizza Express (American Enterprise Institute), both companies with strong brands. In response to greater Chinese consumer demand for Western food, the Chinese government’s intention was for these brands to spread throughout China and beyond (Pingali 2007; Bullock 2017).

These five rationale for Chinese outward investment show that China is a complex country with competing interests, but that the UK fits into all of these interests. These rationales tackle different problems and affect different time periods, with resources being the most prominent issue in the 2000s, and portfolio diversification, brand names acquisition and technology becoming more prominent in the 2010s. This is reflected in the investment data and the types of investments that China makes in the UK. Prior to 2010, the four FDIs over \$500 million were Barclays, useful for

managing China's affairs in East Africa, and three energy companies (American Enterprise Institute). After 2010, a broader range of UK companies were invested in at a higher overall volume and including several important brand names. Therefore, China's investments in the UK were guided by China's domestic situation and Chinese government strategy.

## **6.5 European Union Game**

The EU is less importance in investment relations than in trade relations because of differences in the level of EU competence. With trade, the EU has full competence over trade policy and to negotiate trade agreements with other states. Naturally, this makes the EU very important when it comes to UK-China trade relations. With investment, the EU does have competence but it is less clear than with trade. EU competence over investment has, also unlike trade, evolved over time. The EU had investment competence prior to the Lisbon Treaty relating to market access, although Chinese investment was hardly an issue prior to 2009 because it was so low: in 2008, net Chinese FDI flows into the EU was \$5 billion; by 2013, it was \$24 billion (OECD data). The Lisbon Treaty formally gave the EU competence on FDI more generally, although there were ambiguities over the full extent of that competence, demonstrated by legal disagreements between the Commission and member states over whether FDI was an exclusive or shared competence (Titi 2015: 642). It is argued below that these ambiguities constrained the EU during the period.

The EU was relevant to UK-China investment relations in three additional ways. There have been proposals to give the EU more control over inward investment in sectors that are sensitive to security interests, similar to the Committee on Foreign Investment in the United States. Secondly, trade agreements sometimes have an impact upon investment, such as China's WTO accession opening up China to European investors to a greater extent. Finally, there are Europe-wide institutions, such as Eurochambres and the European Union Chamber of Commerce in China, that have links to the EU and help European businesses have investment relations with China.

Ultimately however, despite this, the politics of Europe-China investment relations centred on the competition of EU member states, particularly the UK, France and Germany. Although this section tries to disentangle EU-China relations and China's relations with individual states, they are difficult to separate because member states influence EU policy. This section discusses FDI between the EU and China in both directions before covering the fragmentation and competition between EU countries for Chinese investment. Finally, the section discusses the proposed investment treaty, its rationale and the problems that stand in the way of negotiation.

### ***6.5.1 EU Outward FDI to China***

In the decade leading up to the 2007 financial crisis, FDI flows between the EU and China was low. Figure 22 below shows EU FDI outflows to China (UNCTAD), showing a 'spiky' graph with a slight upward trend until 2011. In 2006, the \$5.4 billion outflow made up just over 1% of the EU's worldwide FDI outflows (OECD), but 7.5% of China's worldwide FDI inflows (UNCTAD), showing the investment is more significant to China in proportionate terms. The EU plays an insignificant role in this outward FDI, as the lack of capital controls mean that regulation comes from China as the designation country.



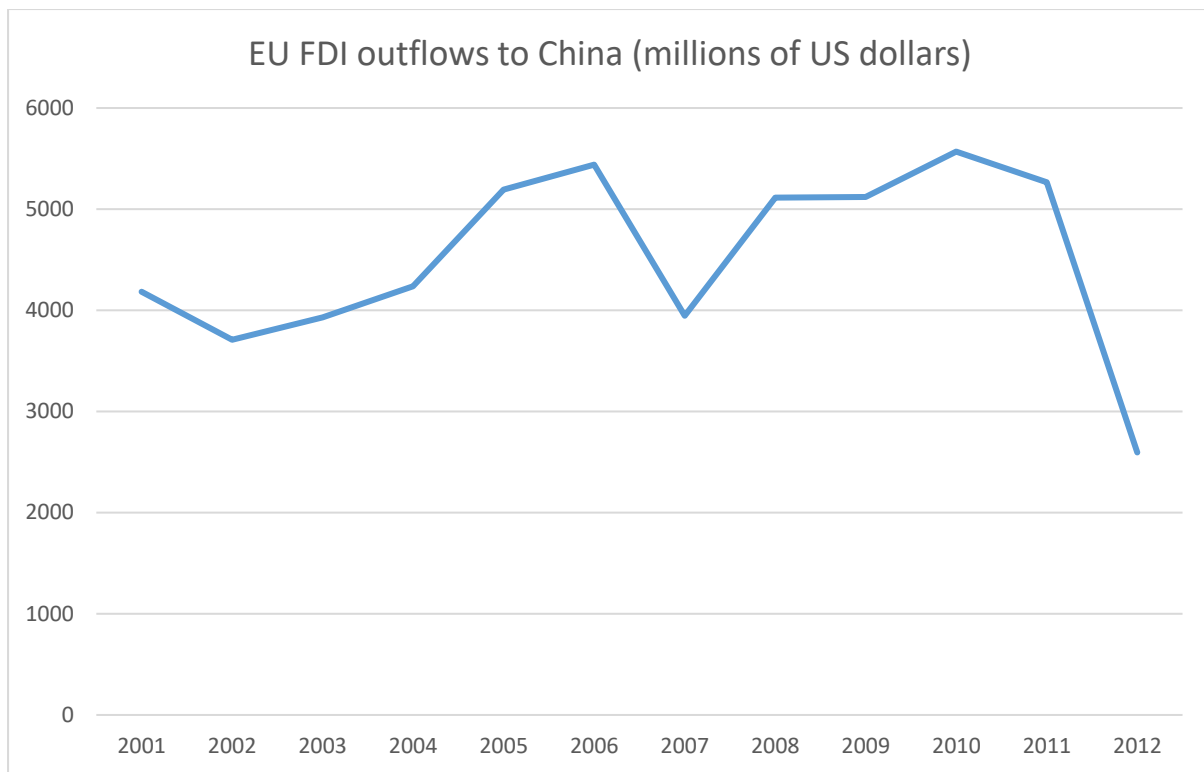


Figure 22 - EU FDI outflows to China (UNCTAD)

What the EU does want is greater reciprocity in openness to investment, since the EU is considerably more open than China is. The European Commission (1998: 12) said “improving the climate for European investment in China should...be one of the EU's top objectives”. Openness to investment was one of the EU's reasons for supporting WTO accession (European Commission 2003). EU companies do benefit from investing in China for the export-seeking and market-seeking reasons previously explained (Casarini 2006: 12; Meunier 2014a), but would derive greater benefit were China to be more open to inward FDI.

### 6.5.2 FDI Inflows

The most important aspect of investment relations was China's outward FDI into the EU. The change in China's economic model led to a significant increase in Chinese OFDI, including into the EU. The stock of Chinese FDI in the EU tripled between 2008 and 2010, tripled again in 2011, and then tripled again between 2012 and 2013 (Meunier, Burgoon and Jacoby 2014). The EU did not play a significant role in this,

but rather this increase was driven by the Chinese side, with China’s overall OFDI increasing substantially as argued in the previous section.

The EU has some competence over investment, although there is ambiguity over the extent of this competence (Meunier 2014c: 997). As will be argued below, these legal ambiguities are one of the reasons why an EU-China investment treaty has been delayed. In the absence of a unified investment deal, many member states have individually made bilateral investment treaties (BITs) with China. Many of these BITs go back a long time – the UK-China BIT was agreed in 1986 – but remain in force. This structure allowed China to pursue investment relations with individual European countries, despite the wishes of some within the EU (Zhang and Van Den Bulcke 2014).

Despite the popular perception that China was “taking over Europe” (Wroe 2011), Chinese investment had little impact upon the EU’s economy. As previously mentioned, the separation between ownership and control in Europe meant companies’ operations did not change when China invested in it. Furthermore, even by 2015, the stock of Chinese investment relative to total investment was around half a percent, lower than the US, Canada, Switzerland, Brazil and Russia, as shown in table 8 below (OECD; Eurostat). China’s FDI stock in the EU is also lower than the EU’s FDI stock in China. These figures strongly contradict the popular narrative about China taking control of Europe.

*Table 8 - FDI stock in EU28 of selected non-EU countries in 2015 (Eurostat)*

<b>Country</b>	<b>Billion EUR</b>
USA	2381
Switzerland	619
Bermuda	495
Canada	219
Brazil	128
Hong Kong	79
Russia	61

Singapore	57
Mexico	37
China	35

### **6.5.3 Fragmentation of EU Countries**

What has given China power is its ability to make European states compete with one another for investment. By essentially attaching political conditions to their outward investment, China changes the behaviour of European states, particularly on human rights criticism or meeting the Dalai Lama. If a state fails to comply, China simply switches its investments to other countries. Lee and Meunier (2015) shows empirically that Chinese FDI into an EU country falls for around six months after a head of state meets with the Dalai Lama. As argued in chapter three, David Cameron's 2012 Dalai Lama meeting led to an eighteen month diplomatic freeze. After 2013, Cameron failed to publicly mention human rights, which led to the £40 billion of trade and investment deals in 2015. With a fragmented Europe, China's political conditions gave the UK the choice of complying or seeing China's economic diplomatic efforts go elsewhere.

France and Germany have had similar experiences, as the economic cost of speaking out on China's human rights record means they are less likely to do so. Human Rights Watch's Bénédicte Jeannerod (2018) has argued that France has acted with "shameful silence over widespread human rights violations under President Xi Jinping". Germany had a similar experience of a freeze in relations after Merkel met with the Dalai Lama in 2007 (Kundnani and Parello-Plesner 2012). Since then, Merkel has toned down her criticism of human rights in China, in order to attract investment (Heiduk 2014). Both Germany and France have followed the same pattern as the UK in avoiding, or at least toning down, criticism of China.

This race to the bottom is as much to do with perceptions as it is with current economic flows. The material reality is important, but so is the the norm of future investment that European national leaders have. These leaders expect China to

continue to grow for the foreseeable future, and believe that standing up to China on political issues might have future consequences as well as present ones. This is a core part of the thin constructivist argument used in this thesis – that the perception of a growing China and of future capabilities gives China power in the present. In the case of investment, China have more power than one might expect for a market of its size because of the widespread perception that it will continue to grow.

#### ***6.5.4 EU-China Investment Treaty***

The EU and China have sought an investment treaty since 2012, with negotiations formally launched in 2013 (European Parliament 2013). The European Commission says that “the aim is to provide investors on both sides with predictable, long-term access to the EU and Chinese markets and to protect investors and their investments” (European Commission website). The investment treaty is still being negotiated, in contrast to the trade negotiations which stalled in 2011, as discussed in the previous chapter.

The European Parliament (2013) say that there are six main issues justifying EU action to negotiate an investment treaty. Firstly, a poor investment climate with a small proportion of European FDI outflows going to China. Secondly, the lack of a level playing field, with European investors in China facing difficulties. These include “problems with intellectual property, a lack of faith in the impartiality of the legal system, and state-owned Chinese companies and companies with close links to the political elite are given preferential treatment” (European Parliament 2013: 2). These problems are faced by UK companies, and also apply to trade. Thirdly, the lack of a comprehensive framework to deal with disputes. Some WTO rules apply to China, particularly investments that have an impact upon trade. However, not all investment deals are covered by those, and OECD rules do not apply to China since China is not an OECD member.

Fourthly, agreements with third countries are not covered by existing agreements and so may disadvantage EU or Chinese companies. Fifthly, the European Parliament acknowledges concern regarding Chinese investment in the EU. The

European Parliament (2013: 3) say that mergers and acquisitions by Chinese companies have “led to the public perception that Chinese FDI are involved in unfair acquisitions of technologies and knowledge”. An EU-China investment treaty could have in it guidelines on the conduct of state-owned enterprises. Finally, The European Parliament wants to alleviate China’s concerns about investing in Europe. Without an EU-China investment treaty, investment is governed by Bilateral Investment Treaties with each country, which Chinese investors find more complicated than if there were uniform rules for the whole of the EU. This may hurt levels of Chinese investment in Europe.

All these issues are legitimate concerns. However, the EU-China investment treaty had not gone far, certainly by 2015 when this thesis ends its analysis. The EU and China had four rounds of negotiation a year, starting in January 2014 and alternating between Beijing and Brussels (European Commission 2014). Like with trade deals, it is not unsurprising that investment deals would take a long time between two large markets with lots of details to work out. There were two main problems in the negotiation, both of which support the arguments made above about the political economy of EU-China investment: the legal ambiguities about the power that EU institutions have vis-à-vis member states; and the major differences in the objectives of the EU and Chinese government with regard to the opening up of the Chinese market.

Firstly, one of the difficulties in negotiating on the EU side was technical issues brought about by ambiguities in the Lisbon Treaty. Legal questions were raised over the extent of EU competency over investment, particularly since investment is poorly defined in the Lisbon Treaty (Ewert 2016). The EU awaited a European Court of Justice (ECJ) ruling on the EU-Singapore free trade agreement, which included investment, before proceeding with investment agreements with other countries. The legal question was whether the EU had exclusive competence, so it could negotiate deals independently that states would have to comply with, or whether the EU had shared competence with the states, so the states would have to agree. The ECJ ruled in 2017 that the EU only had shared competence with member states on the issues of non-direct foreign investment and dispute settlement, so any investment

agreement must be jointly concluded (Court of Justice of the European Union press release 2017).

This inevitably makes investment agreements harder to achieve because it increases the number of veto points. In addition to the European Parliament and European Council, a negotiated treaty would also have to be approved by each member state. This gives a veto power to every single EU member state, making it harder for EU negotiators and makes the process longer because of the extra time needed to liaise with member states and get their final approval. Reaching an agreement that requires approval from individual member states would be susceptible to the 'race to the bottom' problem described in the previous sub-section. EU states do not want to be seen to be individually acting against China's interests in fear of causing China to block FDI to their country, and thus hurt them economically.

The second barrier to negotiations is the difference of interests over the opening up of China to foreign investment. Despite China's liberalisation, there was still an imbalance in economic openness, with the EU much more open to foreign investment than China was. This meant that while the EU was not being asked to make major policy changes on how it treated foreign investors, China was being asked to do so. As explained earlier on the section on the Chinese domestic game, the Chinese government are careful on how they open up their economy – that's why the WTO accession took so long to negotiate. Much of the subject of the negotiations is about how to open up the Chinese economy to European investors in a way that the Chinese government are comfortable with.

This can be shown through the public reports on the various rounds of negotiations, since the issues discussed are more applicable to the Chinese side than the European side. The EU stated during the first round of negotiations that "One of the EU's priorities in the negotiations will be to remove barriers to EU investors on the Chinese market" (European Commission 2014). MOFCOM said after the eighth round of negotiations in December 2015 that an agreement "injects vigor to deepen China's reform, to expand its opening up, and to construct its new open economic system" (MOFCOM press release 2015). The post-2015 negotiations dealt with expropriation, national treatment, sustainable development and transparency

including procedural fairness (eg European Commission 2017; 2018) – all of which apply to a much greater extent to European companies investing in China.

Looking more broadly, the EU-China investment negotiations need to be looked at in the context of other bilateral investment negotiations. In particular, the US-China investment negotiations that have been ongoing since 2008 are very relevant to the EU-China negotiations and they seem to be going on in parallel (Ewert 2016: 4). Market access for American investors in China is a major issue in the US-China investment negotiations, so it is possible that any concessions the Chinese government makes in negotiations with the US it will make with the EU and vice-versa. This can already been seen with the US and China exchanging negative lists that outline the sectors China wants excluded from an investment agreement, when the EU had independently been asking for negative lists as well. Consistency between EU investors and US investors would make Chinese domestic economic policy simpler.

## **6.6 Global Governance**

Internationally, investment is not regulated as strongly as trade or finance is, as is discussed in chapters five and seven respectively. Investment is generally determined by nation states, mostly the receiving country. International institutions play a role in influencing nation states by policy conditionality, either through joining an organisation or receiving investments or loans from an organisation. The IMF and World Bank have issued loans to countries, usually in exchange for conditions. The UK received IMF loans until the 1970s (Rogers 2012), but that was well before the period studied. China have been wary of the conditionality attached to an IMF loan, and have never sought one (Ferdinand and Wang 2013). Perhaps, the threat of conditionality attached to an IMF loan deterred China from being in a position where it could ever seek one, although the enormous growth of the Chinese economy meant that this was never close anyway.

The World Bank is more relevant, as they provided several loans to China. Between 1<sup>st</sup> January 1997 and 31<sup>st</sup> December 2015, the World Bank approved 314 projects

for China with a total value of £30 billion (World Bank website). These projects included a wide range of issues from highways to forestry to health to education to energy. The reason why China gets so much in development loans from the World Bank is that China is still considered a developing country. Even in 2018, the World Bank says:

“China remains a developing country (its per capita income is still a fraction of that in advanced countries) and its market reforms are incomplete. According to China’s current poverty standard (per capita rural net income of RMB 2,300 per year in 2010 constant prices), there were 55 million poor in rural areas in 2015.” (World Bank website)

This reinforces the argument that China is uniquely an emerging superpower and a developing country. The existence of poverty in China means it natural for the World Bank to offer projects, given the Bank’s objective of reducing poverty. However, it is strange that one of the richest countries in the world on aggregate receives cheap money from an IO.

Conditions on investment policy were attached however when China joined the WTO in 2001. As argued above, China agreed to liberalise its economy as part of WTO accession negotiations and this included on investment policy. Foreign investment was permitted to a much greater extent after accession, which contributed to a significant increase in FDI inflows (Hong Kong Monetary Authority 2002; World Bank). This was one of the EU’s negotiating objectives, to improve EU companies’ access to the Chinese market.

China benefitted from participation in both the World Bank and the WTO. However, China’s membership of these organisations has always been somewhat awkward – more out of mutual benefit than being a 100% comfortable fit. The Bretton Woods conference, which led to the IMF and International Bank for Reconstruction and Development (which became the World Bank) being set-up, took place in 1944 (Dooley et al 1994), when China was not a major player in the world economy and indeed was a different country. When the General Agreement on Tariffs and Trade (GATT) became the WTO in 1995, China was not part of it (WTO website). This



meant that China did not have a major voice in how the IMF, the World Bank or the WTO were set-up. Part of the reason why China joined the WTO was to secure a voice in it (Breslin 2007: 93). As discussed in chapter seven, China's dissatisfaction with the IMF and World Bank was a major reason for setting up the AIIB.

## **6.7 Bilateral Game**

The other four games combine together into the bilateral game. The global financial crisis splits up the period neatly: before the crisis, the main political focus on UK-China investment relations is opening up China's market for UK firms; after the crisis, the focus shifts to Chinese banks, wealth funds and companies investing in the UK. This shift is mainly caused by the domestic situation of both the UK and China, but also by changes in international institutions. The dialogue also increases after the financial crisis, with a China-UK Economic and Financial Dialogue starting in 2008.

Before the financial crisis, investment relations were predominantly about UK companies investing in China. The UK saw a remarkable sixteen year period of uninterrupted economic growth between 1992 and 2008 (Gratton and Kokolakakis 2012), while China was still quiet in global affairs. Bilateral meetings were still primarily about trade and human rights, although investment was relevant to China's WTO accession which the UK supported (UK Parliament 2001). Most investment came from MNCs, which depended more on China's domestic liberalisation, which was driven by international negotiations, rather than political dialogue from the UK. Political dialogue played a role, but only insofar as it resulted in liberalisation on the Chinese side.

The investment relationship changed direction after the financial crisis caused by the change to China's economic model towards greater outward investment, combined with the fall in both private and public investment during the economic crisis and austerity period. One of the main ways in which investment was discussed between the UK and China was through the China-UK Economic and Financial Dialogue (EFD). This began in 2008 and occurred roughly annually thereafter, during which investment was a major topic of conversation (China-UK EFD 2008-2015). The

importance of the meetings can be shown by who attends: typically the Chancellor represents the UK and a Vice-Premier represents China. These are both very senior government ministers, although perhaps asymmetrical since the Chancellor is typically the second most important UK minister after the Prime Minister, while the Chinese Vice-Premier is not necessarily even in the Politburo Standing Committee.

Throughout the seven EFD documents, several themes occur. First, unsurprisingly for diplomatic documents, there is a welcoming of growing investment flows in the EFD documents. Statements such as “Both sides remain committed to further promoting and facilitating bilateral trade and investment” (China-UK EFD 2011) are made across the documents, either explicitly or implicitly. This shows that both countries affirm what liberal international relations theory says, which is that investment, like trade, can be mutually beneficial.

Secondly, support for sovereign wealth funds is frequently mentioned. The fund is not mentioned explicitly, but presumably refers to the CIC. In the first EFD meeting in April 2008, the UK welcomed “the creation of the Chinese sovereign wealth fund, and its potential for investing in our country” (China-UK EFD 2008). In all of the first four China-UK EFDs (2008; 2009; 2010; 2011), sovereign wealth funds were specifically mentioned and encouraged, with the UK welcoming Chinese sovereign wealth fund investments in the UK.

Thirdly, there was a theme of both sides pledging support for economic openness to allow investment to flow in both directions. Both sides pledged support for “open markets” or “opening-up” in each of the seven meetings. This implies support for lowering barriers to investment that exist between the UK and China. Several mentions were made of the UK being a country that was easy to invest in. The third EFD (2010) document states: “the UK is already one of the most open economies in the world to trade and inward investment”. The sixth EFD (2014) document states: “China appreciates the UK’s open and transparent investment environment”. This shows both sides commitment to a liberal economic system.

In addition to themes, specific investment projects and agreements were also discussed at the EFD:

- The EFD was one way to discuss the Memorandum of Understanding on Strengthening Trade and Investment Cooperation in Chinese Regional Cities between the Ministry of Commerce of China and the UK's Department of Business, Innovation & Skills (China-UK EFD 2009; 2010; 2011). This memorandum promoted UK investment into the central, western and northeast regions of China that were less successful than the southeast region.
- The Memorandum of Understanding on Enhancing Cooperation in Infrastructure and will establish an Infrastructure Task Force was also discussed (China-UK EFD 2011), which aimed to increase investment and cooperation in the infrastructure of both countries. Infrastructure was also discussed in the fifth EFD meeting, when the UK confirmed that, for Chinese infrastructure investment projects in the UK, the UK would facilitate the import of equipment and materials insofar as EU law allowed, and that the UK would support giving favourable tax and visa arrangements (China-UK EFD 2013).
- The fifth EFD meeting included discussion on the Manchester Airport City Project, an expansion to Manchester Airport for which the Beijing Construction Engineering Group (BCEG) invested £800 million. The UK confirmed to China that BCEG could make use of favourable visa, customs and tax arrangements for the project; China agreed to set-up a BCEG office in the UK (China-UK EFD 2013).
- Both sides agreed to cooperate on investment in the chemical industry, with UKTI promising to assist "China Petroleum and Chemical Industry Federation seek potential suppliers of fine chemicals and related production technology" (China-UK EFD 2011).
- Both sides welcomed investment in the energy section, and agreed to participate in third markets (China-UK EFD 2011). By 2015, the EFD had a lot to say about energy, with China investing in the Hinkley Point C nuclear plant and offshore wind installations (China-UK EFD 2015). The UK and China also agreed to continue to work together on energy research and improving the energy capabilities of both countries.

By discussing specific projects and agreements, the bilateral game between the UK and Chinese governments was able to promote investment.

In addition to the EFD, investment was a major topic in bilateral meetings and visits after the financial crisis. David Cameron's 2013 visit to China was dominated by investment in both directions. David Cameron brought with him a delegation of 120 businesspeople from the UK. These included people from Jaguar Land Rover, Arts Council England, the British Council, BP, Royal Dutch Shell, Barclays, Ernst & Young, HSBC, London Stock Exchange, GlaxoSmithKline, Zaha Hadid Architects, the Premier League, TalkTalk Telecom Group, the CBI, the CBBC and Virgin (*Guardian* 2013, 2<sup>nd</sup> December). Bringing so many top businesspeople to China on a Prime Ministerial visit had great symbolic value, as it showed Cameron wanted to pursue investment relations with China. The visit also gave the 120 businesspeople opportunities to network with Chinese businesspeople and political leaders. The Germans and French do similar visits with business delegations.

During the 2013 visit, Cameron also promoted the UK as a destination for Chinese investment. Cameron declared: "No country in the world is more open to Chinese investment than the UK" (quoted in BBC News 2013). In an article in *The Guardian*, Cameron (2013) said: "There is no greater advocate of...economic openness than Britain and no better partner for China as it opens to the world." Cameron's argument is that China's opening up is well suited to the UK's historic openness. Chinese investment in the UK is also very much in the UK's economic interest, as argued above. This active promotion of inward investment is also a response to the freeze after the Dalai Lama incident.

However, the biggest diplomatic event promoting bilateral investment was President Xi's 2015 visit to the UK. During this visit, the UK government said that up to £40 billion of deals were signed, predominantly investment deals (UK Government News Story 2015). These deals included:

- £6 billion Chinese investment for the nuclear reactors at Hinkley Point C.
- The Chinese developer Advanced Business Park along with the Chinese investment company CITIC announced they were investing £1.7 billion to building a business district at Royal Albert Dock in East London.

- The Chinese private enterprise group Hualing announced it would invest £1.2 billion into major regeneration projects in Leeds, Manchester and Sheffield.
- The Chinese group Sanpower announced it would invest £600 million in acquiring and expanding the British toy shop Hamleys, including a plan to open stores in China.
- Chinese car manufacturer Geely announced an additional £50 million investment in the London Taxi Company towards research into and launch of the new fleet of zero-emission-capable black cabs.

This was a major diplomatic success for the Cameron government because of the time and effort they had put into promoting inward investment from China. David Cameron's 2013 visit and George Osborne's 2015 visit to China both aimed to boost investment, and the 2015 Xi visit gave them what they wanted.

## **6.8 Conclusion**

This chapter has looked at UK-China investment relations, which was an increasingly important part of the overall bilateral relationship. Before the economic crisis, the investment relationship was dominated in the UK to China direction. In the pre-economic crisis period, the changes in the period came from the international game, in which China joined the WTO in 2001. This opened up China's economy to foreign investors to a greater extent by removing legal barriers to foreign ownership, and lowering trade barriers which encouraged export-seeking investment. In the period prior to the economic crisis, there was a steady increase in the stock of UK investment in China.

As with other issues, the economic crisis changed the investment relationship, as China's economic model changed and the UK saw falling public and private investment. Since the economic crisis, investment was China's main source of power over the UK. China have greater negotiating power in the relationship because the UK has more competition against other countries for Chinese investment than China has against other investors to be able to invest in the UK. In particular, other European countries, notably France and Germany, have also a strong interest in

receiving Chinese investment. This allows China to make political demands, such as preventing other national leaders from meeting the Dalai Lama or criticising China's human rights record, which European leaders have given into. Another political request from China was to join the AIIB, which – following the UK's lead – many European countries did, despite the US choosing not to join.

The UK-China investment relationship has changed things in several ways. The relationship has allowed China to invest in several major projects, some of which it can be assumed would otherwise not have gone ahead. The UK has had to change some political decisions to achieve this, such as the prime minister not meeting with the Dalai Lama. Though for the most part the UK economy has not changed substantially because Chinese ownership does not fundamentally change the way in which the business operates. China has used some of its investments for domestic purposes, including gaining technology and brand names.

Despite the illiberal nature of the Chinese inward investment regime, the liberal IPE model has holds up well. The UK and China, among other countries, display the characteristics of 'complex interdependence' that Keohane and Nye (2012) discuss. Apart from a small number of investments that relate to security, the UK's investments in China and China's investments in the UK do not change the wider economy significantly. Indeed, it is in the UK's interests for the Chinese economy to succeed, and it is in China's interests for the UK economy, and China's investments in it, to succeed as well, so the fortunes of countries rise and fall together. The UK's greater sensitivity since the economic crisis has meant that China has power in this interdependent relationship.

Investment, as argued in the introduction, occurs when a corporation in one country establishes a business operation in another country, either through a new affiliate, acquiring a company or a joint venture. This chapter has argued that investment is a vital aspect of UK-China relations. However there is more to financial flows than simply investment. Worldwide, banks and other financial institutions move trillions of pounds of money and financial products each day. The UK and China are a major part of this since London, Shanghai and Hong Kong are three of the biggest financial

centres in the world. UK-China financial relations have been a growing part of overall economic relations. This will be the subject of chapter seven: finance.

# **Chapter 7: Finance**

## **7.1 Introduction**

The last chapter discussed the politics of UK-China investment relations. It argued that investment was the main source of China's power over the UK since the financial crisis, as the UK wanted inward FDI at a time when China was dramatically increasing its outward FDI. China had considerable freedom to decide where to invest the money, whereas the UK needed the investment. This gave China more negotiating power, which it used to seek to punish the UK diplomatically during 'the freeze' in response to David Cameron's meeting with the Dalai Lama (which links with the human rights discussion in chapter four). The stock of Chinese investments in the UK remained low, though the flows have increased substantially since the financial crisis. For the most part, the Chinese investment did not affect the way that UK companies operate, although some investments had security implications that required closer scrutiny by the UK government.

This chapter moves onto finance, the final of the four empirical chapters in this thesis. Finance has some overlap with investment, in that much investment is made by the financial sector and thus the investment itself and the financial institution making the investment are hard to separate, and particularly so in China given the relationship between the financial sector and the state. For this reason, discussion on investment organisations, such as the CIC, was done in the last chapter and will not be revisited in this chapter. The main issues being talked about in this chapter are the renminbi trading in London and the stock connect between London and Shanghai. International financial institutions, such as the IMF and AIIB, are also difficult to categorise, though they are discussed in this section.

The central argument of this chapter is that London is well placed to partner with China on financial issues, given the nature of both economies. China's high GDP made finance more important, since a larger economy requires a sophisticated financial system and China did not have one. In addition, China's economic size



provided opportunities to shape the global economy to suit China's interests, most clearly with the internationalisation of the renminbi. The UK economy has long had a large financial sector, and the City of London remained one of the world's most advanced financial centres. This made London useful for China's ambitions.

The nature of both countries' economies and the domestic political games gives a certain level of inevitability about stronger UK-China financial relations. The strength of the financial sector in the UK, and the importance of finance to the economy, meant that the UK win-set was narrowly focused on finance, meaning the financial sector had veto-like power over an agreement. In the 2010s, finance was also very important to the Chinese economy, reducing the Chinese government's room to manoeuvre. Therefore, the constraints were such that greater cooperation on finance was always likely to occur.

One strand that runs throughout the chapter – and indeed, through the thesis – is the gap between expectations and material reality. Although China has made its intentions clear about opening up its financial system and has begun making steps to do that, the actual level of progress made is nowhere near as much. China's financial centres are far away from either the level of openness or level of sophistication of global financial centres such as London or New York. The renminbi is not fully convertible, certainly not to the extent of the US dollar or euro or yen or pound sterling. The result of this gap between expectations and reality is that much of the discussion around Chinese finance is driven by futurology – postulating what the future looks like. The thin constructivism comes in very useful here because the future is incredibly difficult to predict and so norm dynamics play a major role.

The chapter is structured as follows. The next section looks at the UK game, explaining that the City of London has been an international financial centre for centuries, helped by its sophisticated institutions, language, education levels and time zone, all of which made London attractive for China. Section three looks at the China game and how the Chinese government sought to maintain control of the economy, whilst trying to improve China's significantly underdeveloped and inefficient financial system. The renminbi internationalisation and the London-

Shanghai stock connect are part of this gradual opening up, although both are at an early stage.

The EU and global governance games are less important than in other sections. The EU has a small amount of competency over finance so is of little relevance. The global governance section is dominated by the rise of the AIIB, which the UK joined as a founding member. The final section looks at the bilateral game between the UK and Chinese governments, and how they worked together for the mutually beneficial projects of renminbi internationalisation in London and the stock connect. The chapter concludes by reflecting on the significance of finance to the overall UK-China relationship.

## **7.2 UK Game**

The size of the City of London means that finance plays a larger role in the UK economy than in most other major economies (Hirst and Thompson 2000). This section explains the reasons for that, including its history and other competitive advantages such as language and time zone. These competitive advantages make the City attractive to China to access financial services. It is also helped that the City has strong domestic power – not quite as strong as some people think, but strong nonetheless – which means that City interests are well listened to by government, particularly vis-à-vis manufacturing. This bias towards finance and big business – which neo-pluralism predicts – helps explain the government's focus on the financial relations with China after the financial crisis.

### ***7.2.1 The City of London***

London has been an internationally-leading financial and economic centre for around 500 years (Kynaston 2012: ch2; Roberts and Kynaston 2001: ch10). The City of London was particularly built up during the days of the British Empire, when London provided financial services across the empire and the City helped the British government fund foreign wars (Roberts and Kynaston 2001: 5-6). The empire has for

the most part formally finished, but the legacy lives on through the institutions, with London moving to specialise in offshore finance (Krozewski 1993). In particular, the Eurodollar market – deposits of US dollars in banks outside of the US – became particularly prominent, much to the benefit of the City of London (Cain and Hopkins 1993: 293). It is this prominence and institutional sophistication that makes the City of London attractive to China.

London's financial centre changed significantly during the Thatcher era, when financial markets were deregulated. On 27<sup>th</sup> October 1986, the London Stock Exchange's 'Big Bang' occurred, which led to various changes including stock trading moving from the floor of the exchange to electronic trading (Clemons and Weber 1990). Other changes include "elimination of fixed commissions, marked increase in the number of market participants [and] change in the structure and ownership of trading firms" (Clemons and Weber 1990: 42). The result of the Big Bang was to make London a bigger global financial centre with an increase in both market activity and financial products available (Roberts and Kynaston 2001). Modern securities markets are attributable to the Big Bang (Bellringer and Michie 2014: 113).

There were several reasons why the Big Bang occurred. The short term trigger was a restrictive trading practices lawsuit brought by the Office of Fair Trading, that the Big Bang settled (Clemons and Weber 1990: 53). There were international pressures, particularly from the US after exchange controls were removed (Plender 1986: 40). The free-market ideology of the Thatcher government was also relevant, as Thatcher changed the policy paradigm from Keynesianism to monetarism (Hall 1993). Fourthly, Dutta (2018) argues that the government wanted the Big Bang because it made it easier for them to borrow money, since the big bang expanded the market for sovereign debt. Finally, technology also played a role by making it easier for transactions to occur more quickly, across a larger geographical area and with a greater number of market participants (Plender 1986).

Philip Augar (2000) argues that this caused "the death of gentlemanly capitalism". Thatcher's reforms in the 1980s led to a change in city culture from one dominated almost exclusively by wealthy, public school-educated British gentlemen to a much

more international culture where most of the financial activity takes place in large banks that are predominantly foreign-owned, albeit British privately-educated people remain overrepresented (Social Mobility Commission 2016). One analogy Augar (2000: 321) uses is that of Wimbledon tennis tournament: “played in London, dominated by foreigners but still a great provider of jobs and cash for the UK”. The City of London’s culture changed, so much so that the “voice of British finance” can said to have changed (Courtney and Thompson 1996). This openness to foreign engagement in London markets attracts people from around the world, including from China.

One of the trends since Thatcher has been the financialisation of the UK economy. Davis and Walsh (2017: 35) argue that there was a “state-facilitated shift toward financial market thinking and practice”. This included both a high proportion of former City workers in government and a paradigm shift towards policies more favourable to the City. As a result of this, and other global shifts, the equity value of the stock market increased from 40% of government income in 1980 to three times government income in 2012 (Davis and Walsh 2017: 34). Private unsecured debt – that is a loan not backed by an underlying asset, such as credit card debt – increased from £5,500 per household in 1998 to £15,400 in 2019 (TUC analysis cited in *Guardian* 2019, 7<sup>th</sup> January). This also allowed consumption to increase, as argued in chapter five. It also meant that the City had a greater role in the UK economy, since more people were borrowing from them.

There are other reasons, besides history and policy, as to why the City of London became so successful internationally. London is in an advantageous time zone, being opposite the pacific, meaning that London’s business hours coincide with the other major global financial centres (Kay 2016). In addition, London’s financial industry benefits from using the English language, which is the most likely language to be used in international business (Plender 1986: 42). The high education standards in British schools and universities is another factor, as are the quality of the legal system (Roberts and Kynaston 2001: 181). These factors contribute to the continued prominence of the City of London in global finance.

This brief summary of the history and competitive advantages of the City of London show how finance is a UK strength that can be useful to China. The City of London has advanced institutions that China does not have but would like to have. Providing the Chinese government allowed it, the City would be a good place for international investors in China to operate. In addition though, China is useful to the City of London since China is a large and growing market that contains plenty of people and businesses to offer financial services to. In theory, there is a mutually beneficial arrangement here, however it is still early days.

### ***7.2.3 Finance in UK Politics***

In many ways, finance is something that affects everybody in the UK. After all, almost everyone uses banks and there is a strong national interest for a stable banking system that allows consumers to borrow money cheaply. However, like with the other UK games in previous chapters, there is a section of society that has a strong interest in the way that the financial system works, which is the financial sector itself. The difference between this and the games in previous chapters is that the financial sector is more powerful than either the human rights NGOs or the manufacturing sector, and therefore the financial sector influenced UK policy towards China to a greater extent.

Scholars have long noted the political power of the financial sector. Susan Strange (1990) argued that finance had “structural power” mainly due to information, and this gave the US and the UK global power. Benjamin Cohen (2018: 48) spoke of “monetary power”, which he defines as “a state’s capacity to avoid adjustment costs, relative to that of other countries”. Marxist scholars have tended to view financial power in terms of class power, as a way for the ruling class to control society (eg Harvey 1974; 2005). Pryke (1991: 197) argues that the City has been able to adapt “through a distinctive social power”. In neo-pluralist theory, Charles E. Lindblom’s (1977: ch13) concept of “the privileged position of business” is applicable to finance.

In the UK, the political power of finance is greater than in other Western countries due to the financial sector being larger relative to the size of the economy. Geoffrey Ingham (1984: 131) argues that there is a “City-Bank of England-Treasury nexus”:

“By the late nineteenth century, the relationship between the City, Bank of England and Treasury constituted a relatively integrated system of interdependencies, in which the practice of any one institution were dependent on conditions provided by the others.”

This is a problem for liberal democracy because of the three institutions, only the City is supposed to have private interests. The Treasury is a department of government and therefore acts on behalf of the whole country. The Bank of England has been nationalised since 1946, when the Treasury was given powers to ensure that the Bank of England acted in the public interest (Bank of England Act 1946). Since 1998, the Bank of England has been an independent public organisation with the power to set interest rates (Bank of England Act 1998).

Despite the formal separation and public interest mandate of two out of three institutions that make up the nexus, there are good reasons why the nexus might exist. Many of the people who work in these three institutions – not just at the very top but all the way down too – have similar social backgrounds, frequently with a public school then Oxbridge education (Ingham 1984: 134; Green 2018: 289). There is also a revolving door between these institutions; for example, many people at the top of the Bank of England previously worked in the City. Furthermore, many have argued that the City’s elitism and political influence is one reason why finance has done rather better than the UK manufacturing sector since the 1960s (Cain and Hopkins 1993: 269; Harvey-Jones quoted in Owen 1999: 406; Kitson and Michie 2014; Baker et al 2018).

Tension between the City and the UK’s manufacturing sector is nothing new. Aside from the City’s elitism, one major historical tension was over the value of the currency (Schenk 2010: 206). The manufacturing sector benefits from a weak pound because it makes their exports cheaper in other currencies and so increases demand for UK manufactured goods. On the other hand, the City prefers a higher pound because its financial assets go further abroad. The City naturally had the

upper hand in this tension, in part because it was closer to the Treasury and Bank of England that set monetary policy (Reynolds 2000: 197). This is a channel through which the success of the City may have harmed the interests of other domestic actors.

Jeremy Green (2018) has used the concept of the ‘City–Bank–Treasury nexus’ to explain what he describes as the City’s reorientation towards China under the Coalition. Green argues that the City has an “entrepôt role”, which gives it a central role in the British economy. This central role “has been reinforced, not displaced, since the Global Financial Crisis” despite government efforts to rebalance the economy (Green 2018: 285). With the help of lobbying from the City of London Corporation, the nexus was re-orientated towards Chinese finance.

Green uses data from two elite interviews to support his claim that the City of London Corporation has been involved in UK relations with China, particularly about renminbi internationalisation. These interviews were with City of London Corporation’s Special Advisor for Asia, Sherry Madera, and an anonymous UK government official. The interview with Madera showed that the City of London Corporation focused:

“on the infrastructural development of an RMB offshore market, using its international networks and parastate identity to work with the London Stock Exchange, HSBC and Standard Chartered banks, Chinese banks in London, and the Bank of China to develop an RMB market in London” (Green 2018: 294)

In addition, Green (2018: 294) finds from the anonymous interview that the renminbi trading was helped by personal ties between Chinese stakeholders and London-based financiers, including Sir Gerry Grimstone and Xavier Rolet. These are private individuals, working for private companies, playing a vital role in the negotiations between the UK and Chinese governments.

Green’s analysis has two problems that require modification. Firstly, the conception of a ‘City–Bank–Treasury nexus’ is outdated and fails to acknowledge the changes to the city that have come about as a result of the big bang. The nexus conceptualisation worked better when the British elite was better defined and the

City contained a high proportion of British people. After the big bang, the City became larger, more spread out and more international. Many of the heads of banks are non-British and since 2013, the Bank of England governor has been a Canadian, Mark Carney (although he has since acquired British citizenship). Green (2018: 289) talks about “cultural cross-fertilisations”, although this is less relevant when a growing number of bankers grew up in different cultures. The City of London Corporation (website) says that, using 2017 data, 41% of the City of London’s workforce were born outside of the UK.

That is not to say that the City does not have disproportionate influence over government. Being such a large and wealthy part of the economy, it would be strange if the City did not have any political influence. Indeed, the neo-pluralism outlined in chapter two explains why business is in a privileged position. There are several channels for this. It is frequently claimed that several political parties, including the Conservative Party, and many influential think tanks receive considerable funding from the financial sector (eg Mathiason and Bessaoud 2011; McClenaghan 2012). It is not surprising, given the size and wealth of the City, that some people from the City would choose to donate money to political causes. It would be difficult to prove that political donations caused policy to change in any significant way with regard to UK policy towards China.

Lobbying from the City is another channel through which the City exercises disproportionate influence. Lobby groups include the City of London Corporation and TheCityUK. The City of London Corporation is an unusual organisation, being partially a local authority for the City of London and partially a representative organisation (City of London Corporation website). It has been harshly criticised by people who are critical of the financial sector as a whole, including Nicholas Shaxson (2011), George Monbiot (2011) and the Occupy London movement (Halvorsen 2016). The City of London Corporation does not lobby on behalf of any individual firm, however it does have agenda-setting power since it is frequently in contact with high-level politicians, such as during the Chancellor’s annual Mansion House Speech. TheCityUK is similar in that it represents the industry as a whole, rather than a specific firm (TheCityUK website). Many industries have representative



bodies, and finance is no different; the strength of these bodies lies in the strength of the industry itself.

However, the clearest way in which the City of London influences public policy is over the technical skills. Technocratic theory is well established in literature and states that modern governments are increasingly made up of people with a high level of technical training and who see themselves as apolitical and therefore less responsive to popular pressures (eg Bell 1973; Putnam 1977; Dargent 2015). Interview data from Green (2018) shows that the City of London Corporation advised the London Stock Exchange, The Bank of China and various British and Chinese banks on how to create a renminbi market in London. The City of London Corporation website says they advised the Treasury on how to enhance London's renminbi trading capabilities. This demonstrates how the City of London Corporation's expertise allowed it to influence the renminbi trading in ways that benefit the City of London as a whole.

A similar phenomenon occurred with the London Stock Exchange Group and the London-Shanghai stock connect. The London Stock Exchange Group is a privately-owned public limited company which describes itself as an "international markets infrastructure business" (London Stock Exchange Group website). Like the City of London Corporation, it has a long and interesting history, going back as far as 1698. When the UK and China agreed to do a feasibility study on a potential London-Shanghai stock connect, the London Stock Exchange Group were supported to carry out the study along with the Shanghai Stock Exchange (China-UK EFD 2015: 7). It is further evidence of 'the privileged position of business' that a private company can use its expertise to advance a government objective.

The second problem with Green's analysis is that he exaggerates the extent to which the City has reoriented towards China. If one looks at clearing volumes, even in 2018 after renminbi clearing had become more established in London, the renminbi trading was tiny. The London Stock Exchange (2018) said that the average daily clearing volume of renminbi were RMB 38.8 billion, which is equivalent to £4.5 billion. This was from the London branch of the Chinese Construction Bank, which – as explained below – was appointed by the People's Bank of China and is the only

permitted renminbi clearing bank. In contrast, there are many clearing banks of other currencies. One large clearing bank, the London Clearing Bank, clears in excess of the equivalent of £1.5 trillion of US dollars, £600 billion of euros and £40 billion of Japanese yen each day (London Clearing Bank website). There are still hundreds of times higher volumes of dollars and euros cleared in London than renminbi. This demonstrates a gap between norms and actual flows, as has been argued throughout the thesis.

### **7.3 China Game**

The Chinese game with regard to finance centres on the government's strategy of gradually opening up China's financial system in the belief that it will lead to domestic economic benefits. There are two aspects to this financial opening up: the first is the internationalisation of the renminbi; the second is the opening up of the Chinese stock market. For both of these issues, there exists a tension between maintaining domestic control and opening up China's financial sector to global markets (Lo 2013: 100-101). For the currency, there exists an "impossible trinity" (Aizenman 2010; Lo 2016), so country cannot have free capital flow, fixed exchange rates and a sovereign monetary policy at the same time. For the stock market, a high level of government control over prices is incompatible with prices being set by international economic forces.

This tension is the defining feature of the Chinese financial game. The CCP does not want to surrender control of the economy or of finance. Yet, the reality is that China's financial system is very underdeveloped and under-internationalised relative to the size of its economy or its reserves (eg Dominguez 2010). Without financial reform, China's future growth will be constrained and its international economic influence limited. The overall result of this – both with the currency and the stock market – was a half-hearted liberalisation that is still yet to go far enough. There has been some opening-up, which involves the City of London, but China is not even close to the financial liberalisation of Western countries or even many East Asian countries. Like with investment, perceptions of China's financial system have gone ahead of the reality of financial reform.

### **7.3.1 Renminbi Internationalisation**

In an international economic system, it is necessary to have international currencies to settle cross-border trade and investment and maintain financial reserves (Liao and McDowell 2015: 402). Historically, the international use of a currency has been associated with overall military and economic strength of the issuing country (World Bank 2011: 129; Rangarajan and Patra 2012: 42), hence the US dollar is currently the world's most-used currency and the default reserve currency. The natural continuation of this historical pattern, is that China's continued rise to economic superpower – as many people assume will happen – will be associated with its currency, the renminbi, becoming more widely used including as a reserve currency (Tappe 2018). Of course, this has not yet happened and, as argued in chapter two, it merely reflects perceptions of the future.

For the Chinese government, the question has been how to receive the benefits of global economic engagement whilst also maintaining party control over Chinese society. The US gains economically from playing a leading role in the global political economy, including the 'exorbitant privilege' of being able to print the world's reserve currency (Eichengreen 2011: ch1), but also has to accept exposure to international risks and economic shocks. China also has to make trade-offs on currency, since a country cannot have free capital flow, fixed exchange rates and a sovereign monetary policy at the same time – a country can only have two of the so-called 'impossible trinity' (Aizenman 2010; Lo 2016).

China's general response to the impossible trinity was to have fixed exchange rates and a sovereign monetary policy, and not have free capital flows. In 1994, China set a unitary exchange rate pegged to the US dollar at 8.3 RMB to \$1 (Eichengreen 2005). In 2005, the peg changed to being managed "with reference to a basket of currencies", which in practice was a crawling peg against the US dollar (Oksanen 2015: 19). The new peg allowed the renminbi to appreciate somewhat, although it was still undervalued particularly given the weak US dollar. Amid the financial crisis,

the renminbi was re-pegged to the US dollar in July 2008, before being re-pegged to the basket in 2010.

There are several reasons why China chose this in the period leading up to the financial crisis. Firms would have more certainty when dealing with foreign trade, which is a particularly issue for Chinese firms seeking to export (Eichengreen 2005: 39). Keeping a closed currency avoids contagion of financial shocks, as was the case with the Asian Financial Crisis avoidance of China (Wang 1999: 538). However, the biggest reason for wanting a fixed exchange rate was to artificially undervalue the currency to make exports more competitive. Different methodologies have suggested different figures for the extent of undervaluation, but an IMF report said between five and twenty-seven percent undervaluation (cited in Reuters 2010). Arvind Subramanian (2010) estimated that the renminbi is undervalued by 30 percent. Wen Jiabao denied that the renminbi was undervalued at all (BBC News 2010, 14<sup>th</sup> March).

This undervalued currency pegged to the dollar benefitted China in several ways, as has been discussed in previous chapters. The undervaluation boosted China's exports since they were made more competitive. This contributed to export-led growth, similar to that seen in other East Asian economies such as Singapore and South Korea (Eichengreen 2005: 43). This export growth encouraged greater levels of export-seeking inward investment. The sterilisation that the PBOC undertook to maintain the peg also led to a significant build-up of foreign reserves, which peaked in 2014 at just under \$4 trillion (Neely 2016). All of these issues affected UK-China economic relations during the 2000s, as it increased Chinese exports to the UK; encouraged UK investment in China; and contributed to providing the capital for Chinese investment in the UK as part of Osborne's drive to gain investment in the following decade.

The financial and economic crisis was a turning point, like with other issues that have been discussed in this thesis. In the aftermath of the financial crisis, the Chinese government – unsurprisingly – expressed unhappiness about the US' exorbitant privilege. For a time, China flirted with the idea of an international currency: at the 2009 G20 summit, Zhou Xiaochuan, governor of the People's Bank of China, argued

it would “reduce the risks of a future crisis and enhance crisis management capability” (BBC News 2009; Pilkington 2013:116). A further sign of China’s unhappiness was shown by its complaints about the use of quantitative easing by the US Federal Reserve, which China thought might erode the value of its dollar reserves (*Telegraph* 2009; Black and Schneeweiss 2013). Despite both of these grievances however, little changed apart from China doing more to diversify its investments.

The tone of the Chinese leadership changed around 2009, towards internationalising the renminbi. This may have been down to the Chinese government agreeing with Eichengreen (2013: 148) that “currency internationalization, appropriately implemented, is in the PRC’s interest”. The 2000s decade had seen significant Chinese growth that meant the Chinese economy was much larger and made up a higher proportion of the global economy. Alternatively, it may have been a short-term response to the economic crisis, as suggested by Bowles and Wang (2013). Either way, the Chinese leadership has promoted the narrative of the renminbi as a future reserve currency. In an interview with the *Wall Street Journal* (2011), Hu Jintao confirmed that he wanted to make the renminbi an international currency, though he said it “will be a fairly long process”. Two of the main ways that the renminbi has internationalised have been through trade and currency swaps and allowing clearing outside of China.

### Trade and Currency Swaps

Renminbi internationalisation has occurred in stages. During the 2000s, renminbi was gradually made available to people and markets in Hong Kong (IMF 2013). Internationalisation proper started in 2010 when select Chinese firms were allowed to use the renminbi to trade with foreign firms (Eichengreen 2013: 149). By 2012, all Chinese firms could trade in renminbi and ten percent of all Chinese trade was denominated and cleared in renminbi, much of which was with other East Asian countries. In addition, currency swaps with the central banks of other countries began from 2009 starting with Latin America and then other countries mainly in close

geographical proximity (Subacchi and Huang 2019; Eichengreen 2013: 150). A timeline of selected currency swaps is shown in table 9 below.

*Table 9 - Timeline of selected currency swaps (Subacchi and Huang 2012; official websites)*

Date first agreed	Country	Amount (in billions of yuan)
March 2009	Indonesia	100
March 2009	Argentina	70
July 2010	Singapore	150
October 2011	South Korea	360
December 2011	Thailand	70
March 2012	Australia	200
June 2013	UK	200
October 2013	EU	350
July 2014	Switzerland	150
November 2014	Canada	200

These currency swaps meant that for the first time renminbi became convertible into local currencies. If a foreign business were to export goods to China in exchange for renminbi currency, that business would be able to convert the renminbi into local currency to use. This has the impact of incentivising renminbi use because foreign businesses knew that their renminbi currency could be useful. Thus currency swaps have the effect of directly encouraging trade in renminbi, although, as argued below, the currency is still infrequently used compared to China's economic size.

Figure 23 below shows how the currency swap between the UK and China impacts upon trade in renminbi. Since July 2013, there has been a currency swap between the Bank of England and the People's Bank of China up to 200 billion yuan. This makes it extremely likely that the Bank of England would have access to renminbi and that it could lend to banks. UK firms then have the option of trading in renminbi because they had more reliable access to renminbi through eligible banks. So far renminbi has only allowed to be used for exports to China, due to China's currency

restrictions (which we will come to below), but this still demonstrates gradual liberalisation.

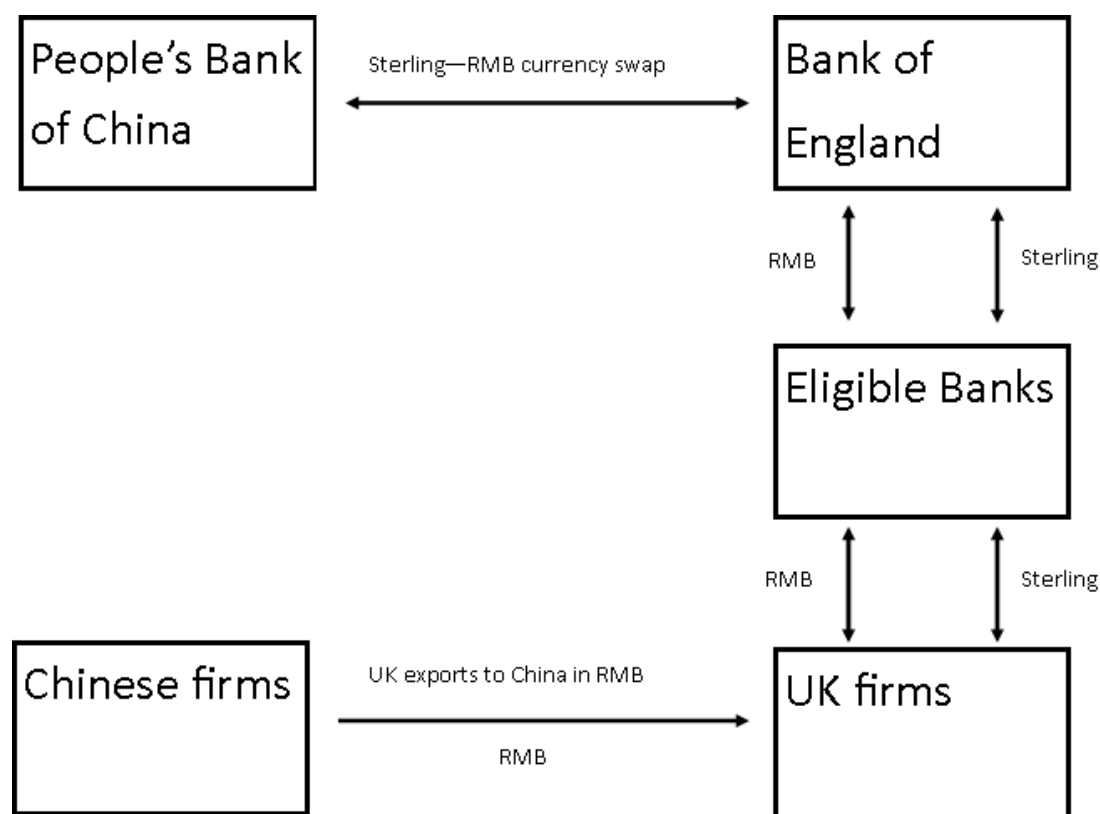


Figure 23 - Mechanics of BSA on trade settlement (based on a diagram in Liao and McDowell 2015: 405)

This currency swaps therefore benefit China in two main ways (Liao and McDowell 2015: 408). Firstly, it reduces transaction costs because the Chinese firm that trades no longer has to convert currency if the transaction is denominated in renminbi. If a Chinese firm was trading with a foreign Asian firm in dollars, then it is likely that both parties would have transaction costs of converting the dollars into local currency rather than just one. The conversion costs also increase the foreign exchange risk of currency conversion caused by currency fluctuations. The second benefit to China of the currency swap is to improve liquidity of renminbi, and therefore improve access to trade financing for foreign firms wanting to trade with China. This should improve trade volumes because it reduced the likelihood of credit shortages.

The UK's role in this is important to China for several reasons. First is simply that the UK is a large economy that does a lot of trade with China. The currency swap limit of RMB 200 billion is one of the highest limits that China has agreed with a country. Second, as explained in the previous section, London is the largest centre for currency trading in the world and has a highly advanced financial industry. If China is serious about internationalisation, then the renminbi needs to be traded outside of China to be a properly internationalised currency. There is a great value to the renminbi of foreign investors experimenting and familiarising themselves with the currency (Cheung 2014), and London is one the best places to do it.

### Clearing Banks

In addition to the currency swaps that China agreed, the People's Bank of China also set-up clearing banks, which further encourage trading of renminbi. Renminbi clearing banks were needed to facilitate offshore renminbi trading because of the liquidity they provide (Nixon et al 2015: 275). Before 2012, the only offshore renminbi clearing banks were in Hong Kong and Macau, so foreign investors would have to go through those financial centres if they wanted to trade renminbi. This is impractical, not least because of the difference in time zone and regulations. Appointing renminbi clearing banks in more countries makes it easier for firms and banks to trade renminbi, which is likely to increase trading volumes. Table 10 shows a timeline of appointment of RMB clearing banks.

*Table 10 - Timeline of appointment of RMB Clearing Banks (from Marconi et al 2016: 14)*

Date of appointment	Country	Clearing Bank	RMB deposits (billions)
November 2003	Hong Kong	Bank of China (Hong Kong)	860
August 2004	Macau	Bank of China (Macao)	N/A
December 2012	Taiwan	Bank of China Taipei branch	302
February 2013	Singapore	ICBC Singapore branch	257
June 2014	UK	China Construction Branch (London)	51



June 2014	Germany	Bank of China Frankfurt branch	12
July 2014	South Korea	Bank of Communications (Seoul)	135
September 2014	France	Bank of China Paris branch	20
September 2014	Luxembourg	ICBC Luxembourg branch	67
November 2014	Qatar	ICBC Doha branch	N/A
November 2014	Canada	ICBC (Canada)	N/A

From a Chinese point of view, this clearing bank achieved two main objectives. The first was to increase the volume of renminbi trade worldwide. This would make the renminbi a more widely used currency, making investors more familiar with the currency and giving China benefits such as lower transaction costs. The second objective achieved by the Chinese government was to make money. The People's Bank of China only appointed one clearing bank per financial centre, meaning each renminbi clearing bank has a monopoly. This allowed appointed banks to earn a higher spread, and therefore make considerable profit.

### SDR Inclusion

The final aspect of renminbi internationalisation that has occurred is the inclusion into the IMF's special drawing rights (SDRs). SDRs are described by the IMF as being an "international reserve asset" and "a potential claim on the freely usable currencies of IMF members" (IMF website). They were originally created to "supplement the stock of official reserves" because the IMF was short of dollars (Alessandrini and Fratianni 2009: 15). In practice, they are rarely used except for IMF internal accounting, but still hold symbolic value (Bernanke 2015). SDRs are made up of a basket of currencies; the currencies before 2015 were the US dollar, the euro, the Japanese yen and the British pound sterling.

China had wanted to be included as part of the basket of currencies making up SDRs. This would be a major symbolic step in the journey of renminbi internationalisation, and demonstrate the extent to which the renminbi had liberalised – a requirement for SDRs inclusion (IMF 2011). The UK supported renminbi

inclusion into the SDRs subject to meeting IMF criteria (China-UK EFD 2015: 7). Xi Jinping had frequently promised the IMF that the renminbi would liberalise, and when an October 2015 IMF report concluded that China had not implemented the demanded currency reform for SDR inclusion, China rapidly complied with the IMF's requests (Foreign Policy 2015). The speed at which China complied in order to meet IMF requirements shows how much they wanted the SDRs inclusion, although they remain a relatively closed economy.

The renminbi being included in the basket of currencies was mainly symbolic, rather than having any significant material impact. Alan Blinder said the SDRs inclusion was a "merit badge" for the renminbi (Bloomberg 2015), while Ben Bernanke (2015) described it as "China's gold star". In the context of SDRs, the People's Bank of China was reported as saying "The Chinese currency has taken steady steps on its global march" (*China Daily* 2017). The normative power that the IMF has in the global economy means that the symbolic significance of SDR inclusion was an important moment.

### *Still Not Fully Internationalised*

While significant progress was made with renminbi internationalisation, it is far from being fully internationalised. The currency is not close to being as open as the US dollar or sterling or many East Asian currencies. An important feature of the renminbi is that the currency is still not fully convertible. Capital controls mean that the capital account remains largely closed (Bonatti and Fracasso 2014; Eichengreen and Kawai 2015). The currency swap agreement has limits, which meant that central banks were only able to swap a limited volume of renmibi currency (shown in the amount column in table 10). The renminbi clearing is also limited and controlled by Chinese banks that are appointed and regulated by the People's Bank of China. This combination of factors demonstrates the extent to which the Chinese government maintains control over renminbi convertibility.

In terms of usage, the renminbi continues to lag behind other currencies, and a long way behind the dollar. As shown in figure 24 below, even in the last quarter of 2017,

the Chinese renminbi was still only the seventh most used reserve currency making up less than 2% of official foreign exchange reserves (IMF), and even that figure includes Hong Kong (in contrast, the US dollar was over 60%). In terms of currency usage in international transactions, the renminbi was the eleventh most used currency for international transactions in 2014 with a 0.5% share (Swift 2015); the most used currency for international transactions was the US dollar with a 51.9% share. This shows clearly that renminbi is still barely used, when compared to the pound, yen, euro and certainly the US dollar.

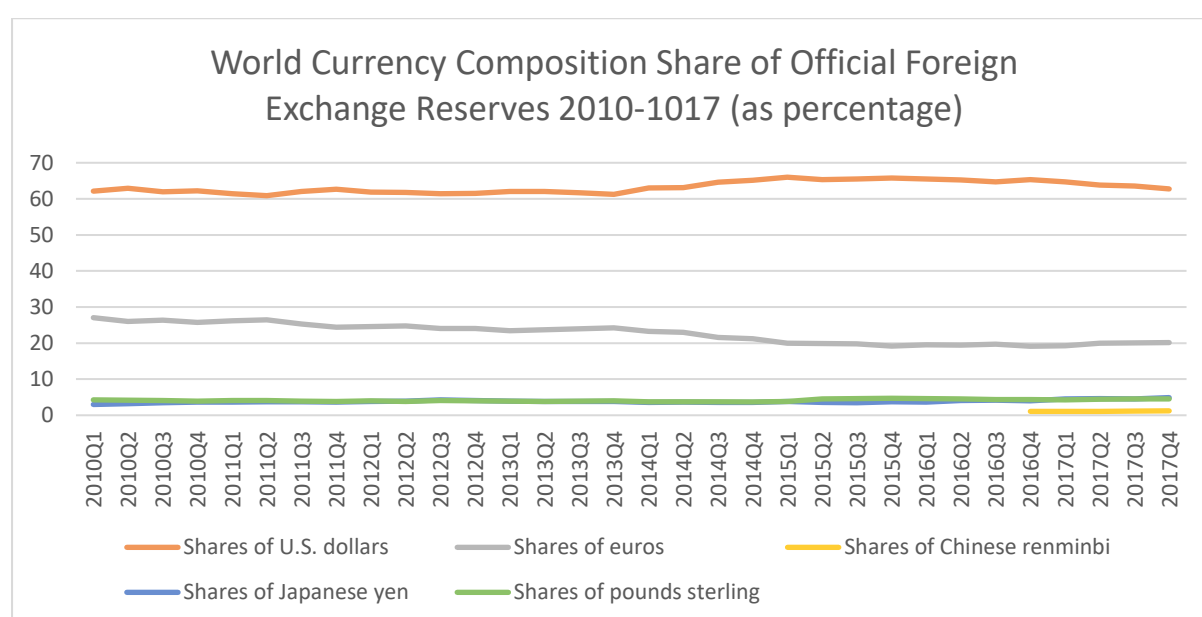


Figure 24 - Currency composition of official foreign exchange reserves 2010-2017 (IMF)

One of the themes of this thesis is that China's power is enhanced by the common assumption that China will continue to grow economically. This is even truer of finance than the other topics in this thesis. China has a weak, underdeveloped financial system and an only partially convertible currency that is barely used outside East Asia. Based on the data on currency usage considered above, it was questionable to include China in the IMF's basket of currencies, given the renminbi's 2015 international usage was on most measures below the Swiss Franc and the Canadian dollar, and on some measures even below such currencies as the Thai Baht and the New Zealand dollar, all of which are not included. In terms of

international usage, there is no material reason for including the renminbi but not including the Canadian dollar or Swiss franc.

Evidence for the importance of perceptions is also provided by policymaker discourse. The then-IMF Director, Christine Lagarde, said:

“The Renminbi’s inclusion reflects the progress made in reforming China’s monetary, foreign exchange, and financial systems, and acknowledges the advances made in liberalizing and improving the infrastructure of its financial markets. The continuation and deepening of these efforts, with appropriate safeguards, will bring about a more robust international monetary and financial system, which in turn will support the growth and stability of China and the global economy.” (IMF 2016, 30th September)

It is curious that Lagarde’s emphasis here is on progress and encouragement of further liberalisation rather than current material facts. This supports the argument that the IMF’s decision was based upon projections of the future rather than simply material concerns. China’s continued economic growth and future contribution to global growth are evidently at the front of the IMF’s mind, as is financial liberalisation. Based on Lagarde’s reasoning, one can infer that a China in the same material position but without the strong growth perceptions would not have been included in the IMF’s basket of currencies.

The forward looking-nature of the IMF’s decision is confirmed by another statement made by the IMF’s Director of Strategy, Policy, and Review Department, Siddharth Tiwari, who said:

“We expect that the inclusion of the RMB in the SDR basket will further support the already increasing use and trading of the RMB internationally.” (IMF 2016, 29th September)

Like Lagarde, Tiwari implies that projections of the future are affecting present decisions. Tiwari fully expects renminbi trading to increase internationally, and expects the IMF decision to support that increase. This once again demonstrates the

dialectical relationship between material and ideational factors, and that the IMF decision was based on perceptions of the future rather than brute material facts.

### **7.3.2 Stock Connect**

In addition to renminbi internationalisation, China also desires to internationalise other parts of financial system. In particular, the Chinese government have stated that they aspire to make Shanghai a top international financial centre by 2020 (*China Daily* 2016). The Shanghai Stock Exchange (2018) say: “opening up to the outside world is the only way for China to achieve prosperity and is also an inevitable trend for the future development of China's capital market”. The stock connecting with other major international financial centres, including London, is part of this opening up.

China's stock exchanges in Shanghai and Shenzhen have always been subject to a high degree of government control and have been reasonably closed off or restricted to foreign investors (Fernald and Rogers 2002). This is particularly true when compared to other large stock exchanges, such as in London or Hong Kong or New York. Whereas in these markets, foreign and domestic investors are treated the same, “many companies on China's stock markets have separate, restricted classes of shares for domestic residents and foreigners” (Fernald and Rogers 2002: 416). This gives the government more control over the value of the stocks, and can guide them towards stability.

The domestic interest in a more advanced financial sector is primarily driven by economic performance. As China's economy grows and becomes more complicated, the ability to channel money more precisely into high-return investments becomes more difficult and requires higher technical skill levels. Therefore, for China, “the development of their capital market and corporate governance becomes an increasingly important issue” (Cumming et al 2015: 1). As argued in chapter two, the Chinese government's main basis for legitimacy is economic growth, and so the underlying logic for stock exchange opening up is to improve China's economic performance and thus boost government legitimacy.

This is another area where the City of London can be useful to China. London has had one of the world's most developed capital markets for centuries and continues to be a world leader in its foreign exchange markets and stock exchange, among other markets. China could learn from London's experience and try to apply it to Chinese financial markets and/or develop links to London. As explained below in the section on the bilateral game, China and the UK discuss ways to do this in the Economic and Financial Dialogue from the very first meeting in 2008 (China-UK EFD 2008).

However, like with renminbi internationalisation, it is still early days. By 2015, the only thing to have actually taken place was a feasibility exercise which, while an important part of planning for the future, does not change the actual functioning of Chinese stock markets. Furthermore, investors do not necessarily trust the Chinese government, given their interventions in financial markets (interview with senior investor 2019). Like with many of the other topics in this thesis, there is a gap between perceptions and material reality. The thin constructivism outlined in chapter three is a useful tool for explaining this

#### **7.4 European Union Game**

The third level – the European Union – does not have a significant role to play in UK-China financial relations. This is because the EU's competence on finance is not applicable to UK-China financial relations, in contrast to trade where it has sole competence as discussed in chapter five. A UK government (2014: 13) report on *The Balance of Competences between the UK and EU on financial services* states:

“In the area of financial services, the EU necessarily operates within a framework of global standards due to the fact that financial markets are global.”

This neatly summarises the EU's competence on finance: since financial markets are international, the EU's power is limited. The interdependence of financial markets means that “risks in one market may be quickly transmitted to other markets, as has

been seen during the recent global financial and euro area crises” (UK Government 2014: 13). Regulation is only effective if it happens at the global level.

There are two roles that the EU plays with regard to finance. The first role, which it has performed for the longest, is in ensuring that the integrity of the single market is maintained, including for financial products. The single market means that if a product or service is available in one EU country, then it must be available in all countries (Barnard 2013). Since the Maastricht Treaty, one of the ‘four freedoms’ has been freedom of capital. Much of this had a minimal impact on the UK domestically however, since the UK financial sector was already considerably liberalised from the Thatcher period (UK Government 2014: 19). Part of the EU’s initiatives on finance also relate to the Euro and the banking union, which the UK has fully opted out of (UK Government 2014: 18).

The second role which is more relevant to UK-China relations is to incorporate international agreements into EU law. As discussed in the next section, there is international governance of financial markets, which is sensible given their international nature. These international agreements however, are not legally binding which gives the EU a role in incorporating international agreements into EU law (UK Government 2014: 14). For example, the Third Basel Accord was introduced into EU law through the Capital Requirements Regulation 2013 (James 2016). However, this is of little political significance, since the UK would have enforced these international agreements anyway.

Neither of the two roles played by the EU has a significant impact upon UK-China financial relations. Indeed, because the only real impact of EU financial regulations is on intra-EU transactions, the EU has no significant role in the City of London’s relations with any non-EU country. Posner and Veron (2010) find that EU policymakers were focused on securing “full market integration within the EU” rather than more purposeful financial sector reform. As argued in the previous sub-section, China’s motivation for engaging with the City of London was because of the advanced, international financial centre. China did not plan to use London’s financial institutions as a way of accessing the rest of the EU (Godement and Stanzel 2016).

Both of the key issues in this chapter are unrelated to the EU. On renminbi internationalisation, China's interest in the City of London is because London is the leading centre for international currency trading and that the Bank of England is a central bank managing a major international currency. There is nothing intra-EU about this, with China also having financial relations with Paris and Frankfurt such as by establishing renminbi clearing banks (see table 10). The proposed stock connect is also unrelated to the EU, since it is purely a stock exchange to stock exchange arrangement, rather than crossing intra-EU national boundaries. It can be concluded that the EU game is of very little relevance to UK-China financial relations.

## **7.5 Global Governance**

The international financial system is subject to global rules and norms that are determined at the international level. Naturally, disproportionate power is wielded by the US, as the world's largest economy with the world's reserve currency. However, other major powers have influence too, including both the UK and – increasingly – China. Global financial governance affects UK-China financial relations in two main ways. Firstly, financial flows between the UK and China are subject to international rules, so the setting and changes of these rules affects bilateral relations. Secondly, China's greater willingness to assert its interests – both in the G20 and in the creation of the AIIB – impacts the UK, and to some extent comes at the UK's expense.

International rules on finance are set by Standard Setting Bodies (SSBs). The main SSBs are Basel Committee on Banking Supervision (BCBS) for banking capital requirements; the International Organisation of Securities Commissions (IOSCO) for securities and futures; and the International Association of Insurance Supervisors (IAIS) for insurance (UK Government 2014: 49f). These institutions were originally set-up in the 1980s and 1990s when China's economy was smaller – Basel I occurred in 1988; IOSCO was formed in 1984; and IAIS was formed in 1994 (Norton 2009). This meant that China was unable to influence these SSBs, and ultimately the standards themselves, from the beginning. Thus, like with the Bretton Woods



institutions discussed below and the WTO/GATT discussed in chapter five, the rules of the international financial system were inherently Western biased.

The financial and economic crisis exposed flaws in the international financial system and led to changes in financial rules. The 2009 G20 meeting in London established the Financial Stability Board (FSB), as a successor to the Financial Stability Forum (FSF), and included China (FSB website). This was a significant shift in global financial governance since previous to 2009, developing countries, including China, “had little formal representation on either the FSF or many of the [SSBs] that designed the standards” (Helleiner 2010: 283). This was particularly important since the FSB was toughened up by being more forceful: the FSB Charter (2012: article 6) commits members to “implement international financial standards” and “undergo periodic peer reviews”. Such commitments did not exist in the predecessor organisation, the FSF (Helleiner 2010: 284). If the world was to have tougher international financial standards, it would be considerably lacking in legitimacy if the rules were set by the West, especially so given the rise of the East and relative decline of the West.

This argument that developing countries needed greater representation on IFIs was made strongly by China itself. At the first G20 summit in November 2008, Hu Jintao argued that reform of the financial system needed to be comprehensive, taking into account that different countries are at different stages of development (Xiao 2015: 2028). In an article published in *The Times* prior to the 2009 G20 meeting, Vice Premier Wang Qishan (2009) argued that the G20 needed to “look beyond the needs of the top 20” and that “China believes the developing world should have a stronger say in how the international financial system is run”. Of course the real objective China has here is to break the obvious Western dominance in IFIs, leaving more room for Chinese influence. That not only applies to the G20 and FSB but also the IMF and World Bank.

The reason why China is so poorly represented in IFIs is that they have grown much faster than the West. Voting power in the IMF and World Bank was initially assigned based on the size and stability of each country’s economy and their contribution to the budget (Liao 2015). In the time since, different countries have had different

growth rates but this has not been taken into account in the IMF and World Bank voting power assignment. This significantly disadvantaged China, as it had one of the fastest growth rates in the world. Although the 2010 quota reforms attempted to change it, it still meant that China had less than half the voting power of the US and non-Western countries remain underrepresented relative to the size of their economies (IMF website). Even this very modest change took five years to get through the US Congress, and so could only be implemented in 2015 (Truman 2018).

A second issue that China had with the IMF and World Bank – as with other IOs – was their liberal underpinnings. Although human rights are not explicitly mentioned in their charters, both international organisations place value on political and social rights in addition to purely economic rights. The World Bank requires participation from primary stakeholders in the design and implementation of projects that it provides funding for, which is effectively a requirement for political rights (Bradlow 1996: 49-50). World Bank-funded projects cover issues such as “health, education, social welfare, jobs and property” (Bradlow 1996: 49), which promotes a liberal conception of development grounded in people having social rights. The IMF have included trade and investment liberalisation, privatisation and public sector reform as part of conditions for loans given out, which is grounded in a liberal view of economics (Kovach and Yasmina 2006).

These problems that China had with the IMF and World Bank were difficult to solve internally within the organisations. Although China became the world’s second largest economy in 2010 (depending how you measure it) (World Bank), it did not have the power to change these organisations. The liberal values was so engrained in the organisations’ culture that it would take too long to change. While the 2010 quota reforms did increase China’s voting power, it took significant political capital to get through the US Congress even reforms that were modest.

These challenges can be explained by liberal institutionalism. Keohane (2005) says that the reason IOs are set-up is to share information, reduce transaction costs and enable countries to work together. IOs inevitably have their own processes, their own culture and employ international civil servants who have an interest in continuity –

not least because they want to keep their jobs. Once the institution has been set-up, it becomes difficult to change or reform from the outside. Guzman (2013) even likens the inability of states to control IOs to Frankenstein's monster, the fictional character who turned against his creator and kills several people. If not even the most powerful members of IOs can change its direction, then a rising China would find it even harder.

Instead, China's strategy for reforming the international system was to create a new IO: the Asian Infrastructure Investment Bank (AIIB). Its creation was very much driven by the Chinese government, and signs of Chinese influence can be clearly seen: its headquarters are in Beijing and its first President, Jin Liqun, is Chinese. The AIIB describes itself as "a multilateral development bank with a mission to improve social and economic outcomes in Asia" (AIIB website). Its core principles are listed as "openness, transparency, independence and accountability". It officially opened in January 2016, however the organisation took several years to create it so fits within the time period of this thesis, albeit towards the later end.

The US was wary of the AIIB. Part of this is, understandably, due to the challenge of the US-dominated Bretton Woods institutions. The AIIB threatened to compete for clients and influence, eroding the United States' dominance of international financial institutions (Chan 2017). President Obama said during a press conference that his concerns with the AIIB were down to how it operates (White House Press Conference 2015). Obama was concerned that if the AIIB did not have transparency and/or have high accounting standards then the investments could be misused or end up benefitting the wrong people. While investment in Asian infrastructure was a good thing and could benefit the global economy, Obama argued "what we don't want to do is just be participating in something and providing cover for an institution that does not end up doing right by its people".

Although the AIIB is primarily focused on Asia – the A in AIIB stands for Asian – it was not just Asian countries that joined. On 12<sup>th</sup> March 2015, the UK became the first Western country to announce its intention to become a founding member of the AIIB (Ren 2016: 438). Germany, France and Italy soon followed, also wanting to become founding members. Later, several other Western countries became founding

members, including Canada, Spain, Portugal, Poland, Sweden, Switzerland, Australia and New Zealand (AIIB website).

What is particularly interesting about so many Western countries, including the UK, joining the AIIB is that they chose to join against the wariness of the US. There were many media reports about the US being unhappy that the UK had decided to become a founding member of the AIIB (eg *Guardian* 2015, 13<sup>th</sup> March; *The Telegraph* 2015; BBC News 2015, 13<sup>th</sup> March; *Financial Times* 2015b, 12<sup>th</sup> March; *New York Times* 2015). The *Financial Times* (2015b, 12<sup>th</sup> March) quoted a “senior US official” as expressing concern over the UK’s “constant accommodation” of China. In David Cameron’s (2019: 587) memoirs, he said that the US disliked the UK joining because “they felt it would enhance China’s power in the region”. The *New York Times* (2015) reported that the UK, France, Italy and Germany agreed to join “despite direct pleas from Washington to steer clear”.

The US denied it had explicitly tried to dissuade European countries to join the AIIB. Obama said: “let me be very clear and dispel this notion that we were opposed or are opposed to other countries participating in the Asia Infrastructure Bank. That is simply not true.” (White House Press Conference 2015). Obama blamed “behind-the-scenes quotes” for news outlets publishing the story and said it had not come from an official government source. The statement the White House did give out said:

“This is the UK’s sovereign decision. We hope and expect that the UK will use its voice to push for adoption of high standards.” (Quoted in *Guardian* 2015)

This fits with Obama’s concerns about the standard of operations in the AIIB, but does not criticise the UK per se. Given the UK had already made a decision to join by this point, the US would have had little to gain diplomatically by publicly criticising one of its closest allies.

The reason why the UK decided to join the AIIB was twofold. Firstly, they hoped that by joining this investment bank and winning favour with the Chinese government, that the UK would receive investment from China (though not from the AIIB directly).

China had a large currency reserve in 2015 and had already committed some of it to UK investment. The UK government wanted more investment and were willing to lean towards China's political demands to get it. Secondly, the UK government calculated that China would be the winner of the twenty-first century in terms of global power. As argued earlier in this thesis, UK government ministers repeatedly made statements implicitly asserting that the Chinese economy would continue to grow until it became the world's most powerful country. China's rise to superpower was, in the view of all British governments in the 1997-2015 period, inevitable. That being the case, being a founding member of the AIIB allowed the UK to maintain influence in the region, and thus gain economic benefits in the future.

In a press release, the then Chancellor, George Osborne, said:

"This government has actively promoted closer political and economic engagement with the Asia-Pacific region and forging links between the UK and Asian economies to give our companies the best opportunity to work and invest in the world's fastest growing markets is a key part of our long term economic plan. Joining the AIIB at the founding stage will create an unrivalled opportunity for the UK and Asia to invest and grow together." (UK Government Press Release 2015)

A few parts of this paragraph stand out. Osborne talks about the Asia-Pacific region as a whole and not just China, showing that he hopes the UK will gain influence over the region, even though China is leading the AIIB. The emphasis is on economic growth; Osborne likes East Asia because of its high growth rate, and wants to "grow together" – hoping for the UK to have a growth rate similar to East Asian countries. Finally, the benefit to the UK, at least in the short-term, is economic and through UK companies accessing Asian markets. The seventh China-UK EFD (2015: 1) affirmed the UK's support, with both countries saying they "support the AIIB's aim to be a professional, accountable, transparent and efficient infrastructure financing platform" and that they "share an aspiration for the AIIB to be an integral part of the global financial system".

What is also interesting about this incident is how quickly other Western countries agreed to join the AIIB after the UK announced that it would. The UK announced its intention to join the AIIB on 12<sup>th</sup> March 2015 (UK Government Press Release 2015). France, Italy and Germany announced their intention to join on 17<sup>th</sup> March 2015, just five days after the UK did (BBC News 2015, 17<sup>th</sup> March; *Guardian* 2015, 17<sup>th</sup> March). Spain, South Korea, Brazil, Australia and New Zealand all followed within weeks (Yglesias 2015; *Straits Times* 2015; Australian Government Press Release 2015). The European countries appeared to still be deliberating when the UK announced its intention to join, then they followed the UK in intending to join as well.

This further supports the ‘race-to-the-bottom’ idea that is argued throughout this thesis. The lack of a Europe-wide foreign policy making authority meant that European countries, particularly the UK, France, Germany and Italy, competed against each other for Chinese investment and must kept accommodating China in order to politically undercut other European states to win investment. In the case of the AIIB, there has even been a race to the bottom of US allies including those outside of Europe. The timing of the decisions by the Australian, New Zealand and South Korean governments suggests that the decision by the UK, France, Italy and Germany influenced their decision.

## **7.6 Bilateral Game**

Since financial internationalisation in the Chinese game has only been prominent in the last few years, finance has only been prominent in UK-China bilateral relations over the last few years. Since it started in 2008, the Economic and Financial Dialogue has discussed financial issues in addition to the trade and investment discussed in the previous two chapters. In the early years of the EFD, the financial issues discussed were largely simply affirming Western-based institutions, such as the IMF or Basel, or responding to global events that had already happened. In around 2013, this changed towards a more active effort to link the UK’s and China’s financial systems, which – as argued in the whole chapter – was mainly down to China’s internationalisation of its financial system and currency.

In the years following the financial crisis, the bilateral financial dialogue focused on financial stability, as part of global efforts to recover from the global financial and economic crises. In the first China-UK EFD (2008: 1), the two countries agreed on the “importance of cooperation on a bilateral and multilateral basis to promote economic and financial stability”. The second China-UK EFD (2009), deeply shaped by the G20 summit in London, affirmed financial reform of the international system. The third China-UK EFD (2010: 3) said that “both sides agree on the important role that continued financial market reform and opening up can play in supporting the global economic recovery”. These kinds of discussions are neither surprising nor particularly special; after a major global event like the financial crisis, many bilateral discussions will include discussions on it.

The early EFDs also included commitments to global governance organisations that deal with financial issues. These are mostly Western-based organisations that in the late 2000s and early 2010s China was still supporting. The G20 is described as “the premier forum for their international economic cooperation” in the third EFD (2010: 1). As explained in the section on global governance, the UK and China had shared interests during the important 2009 G20 summit in London. The second China-UK EFD (2009) discussed the London summit and both countries reaffirmed IMF reform as well as reform of the financial system as a whole.

In addition, the two countries agreed to more general financial services cooperation. At the first EFD in 2008, the UK and China agreed:

“a programme of practical China-UK financial services cooperation and exchange of expertise covering banking, capital markets, insurance and pensions, regulatory reform, and financial education and training.” (China-UK EFD 2008: 2).

The EFD (2008: 2) also points out that “UK exports of insurance and other financial services alone to China grew by 69% during 2006”, and that “72 companies from China have listed on the London Stock Exchange”. It can be seen therefore from this 2008 meeting that the UK and China did have some cooperation on finance, even though it was less significant than it would become by 2015. This cooperation in 2008 is not entirely surprising, since London is one of the world’s most advanced

financial centres and China is one of the world's largest economies. It would be strange if not at least some Chinese businesses sought financial services from London.

This financial services cooperation also covered “regulatory exchange and cooperation between their respective financial regulatory authorities” including between the UK's Financial Services Authority (FSA), China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and China Insurance Regulatory Commission (CIRC). The third China-UK EFD (2010: 4) welcomed the “existing strong bilateral supervisory ties” between these organisations and “to continue to build on these ties and on the good cooperation in multilateral regulatory standard setting fora”. From 2010, the Financial Services Authority and the China Banking Regulatory Commission began an “annual bilateral dialogue on regulatory issues” including “stress testing, liquidity regulation, systemically important financial institutions, cross-border supervision, and Basel III implementation” (China-UK EFD 2010: 4).

This regulatory cooperation continued after 2010, and was one of the central financial issues discussed in the EFD. The annual bilateral dialogue on regulatory issues was expanded in 2013 to include the Bank of England, the newly created Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA), PBOC, CBRC, CSRC, CIRC and SAFE (China-UK EFD 2013: 6). This dialogue would have had to have been changed anyway given the dissolution of the FSA in April 2013. Further dialogue between the Bank of England and PBOC continued throughout, with the China-UK EFD (2013: 6) describing them as having an “outstanding working relationship”. Separate regulatory agreements were also made for the securities, bonds and insurance respectively (China-UK 2014).

The importance of regulation in the bilateral dialogue is not surprising, given the size of both economies and the importance of regulatory alignment. It also reinforces the liberal conception of the state in economic affairs, with the state setting the laws and regulating and private actors providing the economic activity. Regulation was not the only issue discussed in the bilateral dialogue, and two issues in particular are highly



significant for UK-China financial relations are the agreement on London-Shanghai stock connect and renminbi trading in London.

### ***7.6.1 Agreements on Stock Connect***

As argued throughout this chapter, China has long looked to London for financial expertise and connections. This is not surprising given London's status as a large and advanced financial centre, and China's growing need for international finance. Although the stock connect has only been a political issue since 2013, the idea that London could be useful to China's financial development is much older. For instance, in the first China-UK EFD (2008) the two countries:

“Discussed the UK's policy experience in developing London and Edinburgh as world-class financial centres, highlighting aspects of the UK's experience which could be relevant to China's own significant efforts to develop its own financial sector and global centres.”

In this sentence, there is an acknowledgement of the UK's expertise in developing 'world-class financial centres' as well as China's desire to build similarly world-class financial centres as well. It is at an early stage, as these are merely discussions, but the intent is there.

In the fifth China-UK EFD (2013: 8), the countries said: “Both sides also support the cooperation between the London, Shanghai, and Shenzhen stock exchanges”. This did not relate directly to a stock connect, rather to regulatory and technical cooperation that is standard among stock exchanges. They also supported Chinese firms choosing to list on the London Stock Exchange. As discussed above in the UK game section, it is curious that a private company is effectively endorsed in a dialogue between two national governments.

The first official announcement of a stock connect was made by George Osborne in a speech to the Shanghai Stock Exchange in September 2015, during a preparatory visit before Xi's UK visit a month later. Osborne (2015) announced a “landmark

feasibility study” with the intention of “UK firms raising funds from Chinese savers, and Chinese firms listing in London”. He argued that a stock connect was mutually beneficial:

“The mutual benefits of connecting our markets are clear – increased access to international capital for Chinese firms, unparalleled investment opportunities for Chinese and international investors, enhanced stability for both markets and efficient allocation of resources – acting as the basis for sustainable economic growth.”

This mirrors the argument about the mutual benefits of the relative positions of the UK and Chinese economy made throughout this chapter.

The seventh EFD in September 2015 discussed the stock connect at length. The document states: “Both sides support the Shanghai Stock Exchange (SSE) and the London Stock Exchange Group (LSEG) to carry out feasibility study on a stock connect” (China-UK EFD 2015: 7). This was part of an overall agreement to “strengthen long term cooperation in the field of capital markets, recognising the unrivalled depth and liquidity of London’s capital markets and the opportunities for raising finance”. The stock connect was also discussed during Xi’s London visit in October 2015 (Shanghai Stock Exchange website).

Stock connects are already used between Shanghai and Hong Kong, and between Shenzhen and Hong Kong. The Shanghai-Hong Kong Stock Connect was started in November 2014, and allowed stocks of hundreds of Shanghai-listed companies to be traded on the Hong Kong Stock Exchange, and vice-versa (Wang et al 2017). The Shenzhen-Hong Kong Stock Connect was started in 2016 and was similar in structure to the Shanghai-Hong Kong Stock Connect (Wang and Chong 2018). In political terms, one would expect these stock connects to be simpler to set-up and govern because they are all within China.

However, the London-Shanghai Stock Connect was not intended to be a replica of the stock connects between Shanghai, Shenzhen and Hong Kong. Managing director at FTSE Russell Asia, Jessie Pak, said that “a London Connect won’t be a copycat, it’s not the same market” (quoted in Reuters 2015). This is partly down to

the time difference, as the eight hour time difference between London and Shanghai means that the stock markets are not open at the same time in contrast to the Shanghai-Shenzhen-Hong Kong stock exchanges. London is also different because of the different investing behaviour: “The Chinese market is more retail, so what exactly are we going to attract retail investors to buy into the London market and vice versa?” (Reuters 2015).

It is important to remember that the stock connect between London and Shanghai has not actually happened. All that was achieved by 2015 is to set up a feasibility study, which is rather different to an actual financial mechanism. The discussion and market interest in this stock connect is purely futurology and is not based on any empirical observation. This is a central theme throughout this chapter of the future-orientated nature of China’s financial relations with the rest of the world.

### ***7.6.2 Renminbi Trading in London***

Use of the renminbi was a central issue in UK-China financial relations ever since China first discussed renminbi internationalisation in 2009. China have desired to use the City of London to internationalise their currency early on. From the EFD, the first mention of renminbi came in 2011 when:

“Both sides welcomed the private sector interest in developing the offshore RMB market in London and the growth of the market to date. They agreed to monitor future progress, engaging in bilateral dialogue and dialogue with other authorities, as necessary, to support the market’s future development and address any financial stability risks that may arise.” (China-UK EFD 2011: 3)

It is interesting that interest in London renminbi use came from the private sector. The bulk of the trading of renminbi would be done by private financial institutions, so private sector interest is important. The states of both countries are important in facilitating and regulating a London renminbi market. Thus, the both private and public sector interests led to a formation of the renminbi market.

In June 2013, a Renminbi bilateral swap agreement was reached between the Bank of England and the People's Bank of China:

“The swap line may be used to promote bilateral trade between the two countries and to support the domestic and financial stability in London's offshore RMB market. The agreement is the first of its kind between China and a G7 country, and both sides welcomed this as an important step that cements London's major role as one of the most important global centers for RMB trading.” (China-UK EFD 2013: 6)

This was a major mechanism for allowing renminbi to be accessed in the UK. As explained in the China game section, having access to renminbi is important to doing business in renminbi. The swap line gives businesses greater confidence that they could trade their renminbi for pounds sterling, which makes them more likely to be willing to export goods in exchange for renminbi.

Renminbi use in London took a significant step forward in June 2014 when the People's Bank of China appointed China Construction Bank in London “as the first clearing bank outside Asia for the Chinese currency, the renminbi” (UK Government press release 2014). Renminbi clearing banks assist renminbi trading “because they have special access to China's onshore foreign exchange market, enabling them to provide liquidity to offshore centres” (*Financial Times* 2016). This was the first time that the China Construction Bank had been appointed as an offshore clearing bank, although they have all been large Chinese banks.

This links in with the spread of renminbi clearing houses. On 18<sup>th</sup> June 2014, the London branch of the China Construction Bank became the first clearing bank for renminbi outside of Asia (UK Government press release 2014). Previous to London, the only clearing banks that had been appointed outside of China were Hong Kong, Macau, Taiwan and Singapore (Marconi et al 2016: 14). London's financial sector was still able to clear the renminbi currency, but had to do this via Hong Kong. This was not entirely convenient because Hong Kong is in a different time zone to London and therefore was not open during much of London's working day. The UK Government (press release 2014) said that the new clearing bank “UK's global

financial services sector the confidence and infrastructure it needs to expand their RMB activities”.

China had developed numerous partnerships with various countries, as explained above in section on the China game, but London is important as the largest foreign exchange market. Cheung (2014) argues that “it is hard to underestimate the potential of London as an offshore RMB market... London could provide critical RMB business services in the western hemisphere and beyond.” It is London’s strength in finance that makes China’s agreements with the UK on finance more significant than China’s agreements with other countries, even Western countries such as Canada, France and Germany.

By 2015, London was the leading hub for renminbi trading outside of China and Hong Kong (Xinhua 2018). This is impressive in relative terms, although the trading volumes were much lower than other currencies. As explained above in the UK game section, clearing volumes in dollars and euros were hundreds of times higher than renminbi. This goes back to the thin constructivism about the gap between norms and material reality and how the importance of renminbi is being overstated.

## **7.7 Conclusion**

This chapter has argued that the UK and China are well suited to a financial relationship given the situation and strengths of both economies. China has a significantly underdeveloped financial system relative to the size of the economy, and needs to improve its capital markets in order to continue to grow efficiently. The renminbi is also under-used internationally compared with what might be desirable for the world’s second largest economy. China were also underrepresented in global financial governance, since the IMF was set-up to favour the interests of Europe and the US. Setting up the AIIB, internationalising the renminbi and reforming the financial system were all Chinese strategies to rectify these financial disadvantages.

On the other hand, the UK has long been a world-leader in financial services. This history has created advanced financial institutions which are attractive

internationally, helped by the English language, high education levels in the UK and the advantageous time zone. The City is powerful politically in the UK since the wealth, technical knowledge and historical quirks of the City give it a privileged position. The City of course have a strong interest in gaining access to new capital and new markets, and they were one of the drivers behind the UK-China financial interactions. The City of London Corporation and London Stock Exchange Group used their technical expertise to influence the negotiations.

Both the stock connect and renminbi trading do well in linking the UK's and China's relative strengths and aspirations in the global political economy. London leads the world in currency trading and has one of the most highly capitalised stock exchanges in the world. London is also not in the US, and therefore is less likely to be affected by US-China competition. London is an excellent place to assist China in its ambitions to internationalise the renminbi and improve its financial system. It is beneficial for the City of London and to the ambitions of the Chinese state.

Of the four topics making up the empirical chapters in this thesis, finance is the most recent. Whereas discussions about human rights and trade flows have occurred since before 1997 and investment has become a prominent issue since the economic crisis, finance has only been a prominent issue in UK-China relations since 2013. Being the most recent of the four topics in this thesis means that finance is the issue most subject to futurology. Trade and investment flows can be measured (with the caveat of data quality problems discussed in previous chapters) and the actual traded goods and investments analysed. The statements made on human rights and democracy by both governments and by NGOs can also be analysed. Finance, however, can only be studied by looking at government's intentions about feasibility studies. There is two years' worth of data on renminbi trading in London, but this is far smaller than for other topics. The way of studying finance has to be different than with the other topics.

This makes the thin constructivism, outlined in chapter two, more relevant for this chapter than for the other three topics. It is still relevant for the other three topics because the perception of China as an emerging superpower affects how businesses and policymakers in the UK think of China and that affects how they

behave. On finance though, perceptions of China affects market mechanisms, such as the stock connect, that have not yet been created. The renminbi's actual level of convertibility and actual use is rather limited, and there is no guarantee that these things will increase in the foreseeable future. Thus, more so than in other chapters, the perceptions matter more than the reality. This will be further discussed in the final chapter: the conclusion.

## **Chapter 8: Conclusion**

### **8.1 Summary of Thesis Argument**

This thesis has sought to explain the evolution of UK-China economic relations in the period 1997-2015. In order to answer this overarching research question, the thesis was structured in the following way. Chapter two set up the study by explaining the theoretical perspective, which is liberal with an element of thin constructivism. It argued that liberal IPE was highly effective at explaining the modern global economy, including China's rise within it. The chapter then explored the attractiveness of a thin constructivist element, particularly with regard to the way China is perceived by other countries. Using this theoretical grounding, a four-level game model was then built using Putnam's (1988) framework. Five games – the UK game, the China game, the EU game, the international organisations game and the bilateral game – are set up and introduced. This chapter contains the outline of all the theoretical tools used in the thesis.

Chapter three gave an outline of UK-China relations 1997-2015, identifying the key turning points. It argued that the 1997-2015 period can be split-up into five stages. The first is the Hong Kong handover, which concluded decades of discussions and, for China, removed an obstacle to happy relations with the UK. The second stage was a focus on trade in the decade between 1997 and 2007, during which China joined the WTO and increased its trade with the rest of the world substantially. The third stage was the response to the global economic crisis after 2008, when both countries attempted to stimulate their economies. The fourth stage was the freeze, which occurred when China cut off diplomatic relations after David Cameron met with the Dalai Lama in 2012. The fifth and final stage was the UK competing for Chinese investment and finance, which led to Xi's big 2015 visit. The purpose of this chapter was to provide a timeline so that a clear ordering of events could be established, which was useful in the analysis in chapters four to seven.



Chapter four was the first empirical chapter and looked at human rights and democracy. The UK and China have very different ideological histories and systems of government, which have evolved over many centuries. This chapter argued that human rights have been the largest source of non-economic tension between the two countries. For the UK, human rights promotion is a stated goal of its foreign policy, and several campaign groups and MPs push human rights issues. China, on the other hand, dislike foreign countries commenting or criticising its domestic policies, including on human rights. The EU's values are embedded in human rights and the EU has its own human rights dialogue with China, but this is incoherent and weak. International organisations are best placed to challenge China on human rights, but are far from fully effective. The bilateral game includes a human rights dialogue, support for specific projects and high-level engagement, but there is nothing to suggest that this achieved anything significant.

Chapter five turned to trade. Trade between the UK and China grew substantially during the period in both directions. The chapter argued that the main cause of the changes in UK-China trade relations was the growth in China's economy. In 1997, China was the industrial powerhouse of the world and so the trading relationship was predominantly about cheap, Chinese goods being exported to the UK. As China's economy grew and its middle class expanded, China became a greater importer of goods, typically high-end, and the low-skill manufacturing moved to other countries. The UK has an interest in both exporting to China and receiving low-cost imports, although there were clear losers as well from the decline in manufacturing. The issue of losers from trade with China affected countries across the EU, which made having a coherent EU trade policy towards China challenging when some countries favoured protectionism and some favoured free trade. On the international level, trade was helped significantly by China's accession into the WTO in 2001, which lowered trade barriers and helped to better integrate China into the global economy.

Chapter six covered investment. The flows of investment increased substantially since the financial crisis, although the stock remained relatively low. Investment was the main source of China's power over the UK since the financial crisis, as the UK was desperate for inward FDI at a time when China was dramatically increasing its outward FDI. This gave China more negotiating power, which it used to seek to

punish the UK during 'the freeze' in response to David Cameron's meeting with the Dalai Lama. Investment was also a contentious issue in Europe, with countries competing to attract Chinese investment, leading to fears of a 'race to the bottom' on security and human rights issues.

Chapter seven concerns finance. The City of London is well placed to partner with China on financial issues because of its advanced institutions, language, time zone and education levels. China's growing power in the international economy, and desire to continue growing, necessitates improvements to its domestic financial system and access to global financial markets. China and the City of London have sought to work together on renminbi trading in London and on a London-Shanghai stock connect, although both are in early stages. The UK has also joined the AIIB, which is thought of as a potential rival to the Bretton Woods institutions.

This concluding chapter offers final thoughts. The next section offers some reasons for change and ranks the four games in terms of importance. The main factors are the growth of China, the changing economic position of China in the global economy and the long-run effects of the economic crisis. Material and ideational factors are important in the changing relationship: material factors because of the increase in the size of China's market and of China's outward investment; ideational because of the change in the way that China was perceived by other countries. The thesis ends with a reflection on future directions in UK-China relations, in the context of Brexit and China's future growth prospects.

## **8.2 The Reasons for Change**

This thesis asks what the main drivers of change were in UK-China relations 1997-2015. To help answer this, a four-level game model was built to organise all the actors and to identify the constraints that changed the bilateral relationship. The power of this model is identifying the domestic, regional and global drivers of change that influenced UK-China economic relations. The concept of win-sets allows the analysis to examine the room for manoeuvre of the UK and Chinese governments, which changes as time goes on. The change in bilateral relations is underpinned by

changes in domestic and international environments, and this is well captured in the four-level game model.

There are four areas that have affected the bilateral relationship: the UK domestic game, the Chinese domestic game, the EU and global governance. Having analysed four main topics using this framework, it is possible to now rank the four areas. It is concluded that the Chinese domestic game is the most important, with the ordering of the other three factors – global governance, the EU game and the UK domestic game – depending on the issue, as they all have relevance to the change in relations.

### **8.2.1 *China Game***

The most important and most obvious reason why UK-China relations have changed is because China's economy has grown. Economic flows are affected by China's increase in purchasing power driven by the growth of the Chinese middle class. As average incomes in China increased, the demand for luxury goods made in the UK also increased, as discussed in chapter five. The rise in China's economy necessitates a more sophisticated financial system, which was the driver of financial links between China and London, as explained in chapter seven. The Chinese economy has changed far more than the UK economy, so it is unsurprising that China is the driver of change.

The game changer though is investment. China's post-financial crisis decision to invest abroad led to significant OFDI flows, as explained in chapter six. China's ability to determine where its investments went gave it power, which was exaggerated by perceptions of China. The UK's reliance on Chinese investment, and the norm of continued investment in the future, gave China power over the UK, seen most clearly on human rights and democracy. The UK government did not criticise – or even mention – human rights between 2013 and 2015, even on Hong Kong, despite having done so before 2012. Given that China caused the UK to do something it would not otherwise have done, it can be said that China has power over the UK, and China's increase in outward investment was the main cause.

### **8.2.2 Global Governance**

Changes to global governance have had a significant impact upon relations, particularly on trade as discussed in chapter five. China's 2001 accession into the WTO was a watershed moment in cutting barriers to trade and investment, which contributed to the large increase in trade seen in the 2000s. China made concessions to be able to join the WTO, which makes this game separate from the domestic game. In addition, China's founding of the AIIB, with the UK's membership, was symbolically significant as it threatened to challenge the Western-dominated Bretton-Woods institutions that had been dominant since World War Two. Both events were important, although the effects of WTO accession are more significant and easier to observe as it happened longer ago. This game is important for trade, of some but limited importance for human rights and finance and very little significance for investment.

### **8.2.3 UK Game**

The UK game has also changed, although not to the extent that the Chinese game has had and in a different way. In material terms, the UK economy, interests and institutions have stayed largely the same, which reflects the UK's position as an old country with long-established, political institutions, but also its modest growth compared to China. In evaluating British decline over the twentieth century, David Reynolds (2000: 1) argued that "it is not simply that Britain changed, but, even more, that the world changed around it". In material terms, a very similar phenomenon has occurred with UK-China relations, as the power shift towards China was driven by China's growth. There was little the UK government could do to affect this global economic shift.

However, one of the arguments of this thesis is that a thin constructivist element is useful in explaining UK-China relations. The UK game is important because of the change in the way that China was constructed by UK policymakers as being more powerful. This "imagined power" (Breslin 2015: 236) exaggerated the shift in material power that had occurred. This was relevant to investment and finance because the

UK was forging links with China based upon how they expected the Chinese economy to develop, rather than how it was now. However, the biggest area where this made a difference was human rights because the UK construction of China's power made the UK government reluctant to criticise China's human rights record after 2013. The UK government's behaviour changed as a result of this imagined power.

#### **8.2.4 EU Game**

There were modest changes to the EU game throughout the period. Though the divergence of interests did not change, they became more pronounced as the trade and investment flows increased. Fox and Godement (2009) do well at revealing EU states' divergences in trade interests, although this became an even bigger issue with the competition between EU states for investment (Meunier 2014a; 2014b; 2014c). The EU itself only changed modestly – increasing its membership and changes to investment competency and foreign policy under the Lisbon Treaty (2009). The EU did not affect finance to a significant extent because it does not have competence. The EU did not affect human rights issues because of the fragmented nature of multiple human rights dialogues. Overall, the EU did play a role in the evolution of UK-China relations, although it was certainly less important than the Chinese domestic game.

### **8.3 The Future of UK-China Relations**

This thesis has covered the period 1997-2015 and so has largely avoided the issues since 2015. The thesis has also thus far avoided speculating on what might happen in the future – or rather only taking about the future as it empirically relates the present. For this final section, the analysis will be opened up to learn lessons about relations in order to inform the future. Some aspects of relations are inevitable, but some are not. The two big issues in future UK-China relations are Brexit and China's long-term growth prospects, and both of these are discussed.

Some aspects of the UK-China relationship are inevitable and will continue long into the future. As mentioned in chapter four on human rights, the UK and China have distinctive cultures that have evolved over an extremely long period, going all the way back to ancient times. While globalisation has a homogenising effect, the effect is not absolute and the cultural differences will continue long into the future. Conceptual differences over issues such as human rights and the rule of law will continue. One improvement could be that China and the West's awareness of the other's culture will increase so the cultural differences come as less of a shock.

One of the questions that has been present throughout the thesis is whether, from a UK perspective, there is a tension between political dialogue, on issues such as human rights, and economic deals. This thesis has taken the view that there is some diplomatic tension, but not as much of a tension as the Chinese government want the UK to believe that there is. The UK remains a major power with plenty of economic opportunities for China, most clearly in finance. In this context, the UK could still have scope to have both lucrative economic deals with China and – ideally at a multi-lateral level – constructive political dialogue with China. This tension will become more pronounced if the power in the relationship continues to move towards Beijing.

Human rights promotion and advantageous economic deals are best achieved from a position of strength. A more powerful country has more leverage to promote human rights and negotiating favourable trade, investment and finance deals. In terms of the political future, there are two main issues that will determine UK-China relations over the coming years and decades. The first is Brexit and the UK's future relationship with the EU, which affects UK foreign policy significantly. The second is China's future growth prospects, which have been the main determinant of China's relative power vis-à-vis the UK (and indeed the West generally).

### **8.3.1 *Brexit***

During the period that this thesis studies, the EU has played an important role; so much so that one of the levels in the four-level game model is the EU. The UK's

trade policy towards China has been set entirely at EU level, as discussed in chapter five. The EU was part of the government's strategy on human rights and had some impact on investment and finance. To be leaving this institution after it has such an impact on foreign policy is a significant change. At time of writing, the exact form that Brexit will take is still unclear (if indeed it happens). What is clear is that the UK's relationship with the EU will continue to be an issue for years to come.

China was used by both sides in the debate leading up to the 2016 referendum. One of the main "Leave" arguments for why the UK would be better off outside of the EU is that the UK could make independent trade deals with third countries. The Vote Leave website criticises the EU for failing to agree a trade deal with China, and points to the ability of Switzerland and Iceland to do deals with China as evidence of what the UK could negotiate outside the EU (Vote Leave website). In this line of argument, the UK could negotiate deals better tailored to its specific needs, rather than having to negotiate as a bloc with the rather different preferences of Southern and Eastern European countries.

For the "Remain" campaign, China was used to argue for the UK having a strong place in Europe, where they argued its power would be greater. John Major argued that in the result of Brexit, "the EU would be gravely weakened, especially when set against the power of the US and China" (Stronger In website). According to this argument, a strong Europe was necessary to promote European values and a weaker, post-Brexit Europe could not do that as effectively. In addition, Remain campaigners argued that single market access was necessary for strong economic relations with third countries. David Miliband argued that EU membership was essential for strong relations with China because of the access to the entire EU market that the UK provided (Stronger In website).

There is truth to both of these arguments. Were the UK to leave the single market and customs union, it would be free to negotiate a trade deal with China. The UK could negotiate in accordance with its interests and probably more efficiently than the EU has done, given the coordination problems that exist within the EU. The UK is also generally more supportive of free trade than most other EU countries, as argued in chapter five. However, China has its own interests as well, and has shown

ruthlessness at negotiating trade deals in the past (Brown 2016, 10<sup>th</sup> October). The UK has a smaller market than the EU as a whole so there would be a reduction in negotiating power. Overall, the choice for the UK with regard to China was between having more negotiating power with a less tailored negotiating position, or less negotiating power with a negotiating team solely committed to UK interests. It is difficult to choose between these options without greater empirical testing that would be impractical. As Kerry Brown (2016, 10<sup>th</sup> October) argues, it would be unwise for a Post-Brexit UK to rely upon a good deal with China.

What complicates Brexit at time of writing is the lack of clarity over what Brexit will look like. It is unclear what customs arrangements the UK would have with the EU, were Brexit to happen. Even if there were to be a clean Brexit, that would not necessarily end domestic debate on the EU; it is entirely plausible that, were the UK to leave the EU, there could be a campaign to re-join. This uncertainty does not help the UK economy or foreign relations, but it is likely to be a feature of UK-China relations for the coming years.

### ***8.3.2 China's Long-Term Future***

This thesis has argued that the main – and also most obvious – reason for the change in UK-China relations has been the economic growth of China. The power increase associated with the material increase in GDP has been exaggerated by the imagined power that comes as a result of the widespread assumption that China's economy will continue to grow. Given that economic size is a major determinant of a country's political power, and power affects the outcome of bilateral negotiations, it seems intuitive that the future dynamics of UK-China relations will be affected by the relative sizes of the UK and Chinese economies. Since the UK economy has had steady and, by Chinese standards, modest growth over the last century, the most important determinant of relative economic size difference will be the future growth of the Chinese economy.

For some, China's continued rise is inevitable. The George Osborne view is that the twenty-first century will be China's and there is little that anyone can do to stop it:



“China is what it is. We have to be here or nowhere” he argued on a 2013 trade mission (*New York Review of Books* 2013, 19<sup>th</sup> October) Later, George Osborne and Jim O’Neil (2015) explicitly asserted that China is “the world’s next superpower”. However, there are many reasons to doubt that China’s growth will continue in the way that it has. As Joseph Nye (2010: 150) argues, “As countries develop, there is a tendency for growth rates to slow”. There are diminishing returns to capital and technological transfer, which has already reduced China’s trend growth rate (*Economist* 2015, 11<sup>th</sup> March). Furthermore, China’s demographics are against them, as the effects of the one child policy means the working age population has already peaked. All of these factors point to China’s growth being proportionately slower over the next forty years than it has over the last forty years.

On the other hand, some argue that China is doomed to collapse. Gordon Chang (2001; 2011) argued that there was a “Coming Collapse of China” due to the inefficiency of the banking system and the CCP’s inability to deal with social disagreements. This collapse is yet to happen, despite Chang’s predictions. Even if there was a financial crisis, China would likely bounce back like Indonesia did after the 1997 Asian Financial Crisis. Chang argues that a revolution is possible, and China certainly has had its fair share of revolutions in its history. However, the lack of an identifiable opposition in China means that it is unclear where this revolution would come from. There has been little evidence of democratisation, so that is unrealistic in the near future too.

The reality is somewhere in the middle. China is not going to continue growth rates of ten percent, but is also not going to collapse. Geopolitically, this means continuing at number two for the foreseeable future. The US is still far ahead on both military spending and GDP. However, even if China were to catch up with the US on these two measures, it would still face key disadvantages relative to the US. The US uses a more widely spoken language, has a more advanced financial system, has better universities, has more transparent political institutions that better respond to public demands, has a high level of soft power thanks to Hollywood and would have a higher GDP per capita. Many of these things, including banks and universities, have taken a long time to develop, which gives the West entrenched advantages.

One of the interesting questions that remains unanswered is what happens to China's political system if average incomes continue to rise. As Nye (2010: 150) argues, "China has not yet found a way to solve the problem of demands for political participation (if not democracy) that tend to accompany rising per capita income". For most high-income countries, located in the West, democracy satisfies this need. China has shown little sign of democratising, aside from a limited number of very flawed elections at grassroots level (Brown 2011). Incorporating a growing middle class into a political system that is already squeezed will be a major challenge for the Chinese leadership.

To a large extent, China's future growth is still in the hands of current and future governments. In many ways, the causes of China's impressive economic growth since 1978 have been similar to the causes of the West's growth since 1500. Niall Ferguson (2012) has argued that there are six "killer apps" that explain why nations are economically successful – competition, the rule of law, consumerism, medicine, science and work ethic. Ferguson argues that the West had these from 1500, which is why they pulled ahead during the 'great divergence', but that China have begun to adopt these, albeit with Chinese characteristics, which explains their comeback. The big question, not only for UK-China relations but also for the future of the world, is: can China adopt the political, social, environmental and economic reforms necessary to continue on its rise to superpower and lead the world in the twenty-first century?

## **9 Postscript: UK-China relations 2015-2020**

### ***9.1 Introduction***

This thesis covers UK-China economic relations during the period 1997-2015. As explained in the introduction, the end date of 2015 is imperfect and is down to a combination of being the high point of the golden era and practical considerations. This postscript aims to deal with the period between 2015 and the present by explaining how some of the key issues have progressed. The biggest of these issues is, unsurprisingly, Brexit, which is likely to transform the UK's international relations. Other issues covered in this postscript are the Hong Kong protests; developments in US-China relations, including the trade war; EU-China relations, including the debate over MES; and investment screening.

### ***9.2 Brexit***

The EU referendum on 23<sup>rd</sup> June 2016 was a watershed moment in modern British political history. The issue of Brexit has dominated political discussion in the years since and has caused considerable political uncertainty. David Cameron resigned after the referendum and his successor as Prime Minister, Theresa May, negotiated a deal with the EU that was rejected by the House of Commons three times, leading to Brexit being delayed and Theresa May resigning (Walker 2020). New Prime Minister Boris Johnson re-negotiated the deal with the EU that, following the Conservative majority in the December 2019 general election, was approved by Parliament. The UK left the EU on 31<sup>st</sup> January 2020 and is currently in an implementation phase, which is due to end on 31<sup>st</sup> December 2020 after which the future relationship begins.

There are signs that the Chinese government have looked for positives in Brexit. As discussed in the conclusion, Brexit will mean that the UK can sign its own trade

deals, instead of being part of the EU's trade deals. Theresa May's visit to China in January-February 2018 was in part concerned with a post-Brexit trade deal (UK Government Press Release 2018, 1<sup>st</sup> February). The China-UK Joint Trade and Economic Commission was set-up to promote UK-China trade and investment and is looking at post-Brexit trade and investment relations (EFD 2019: 5). The Chinese Ministry of Commerce have already confirmed that a trade deal is possible (Godement and Stanzel 2016). The UK and China also remain committed to ensuring that investment and financial relations are not disrupted by Brexit (EFD 2019: 2; 16).

Godement and Stanzel (2016) discuss the difference in attitude towards Brexit between the Chinese and Japanese governments. The likely economic impact of Brexit on Chinese interests is better than the impact of Brexit on Japanese interests. This difference can be straightforwardly explained using a rationalist framework because of the respective economic interests of China and Japan. A major part of Japan's economic interest in the UK is its greenfield investments in manufacturing, which is sensitive to currency fluctuations. Japanese investments are also more likely to involve trade with the rest of Europe, which will become more difficult and costly after Brexit. China's economic interests are more focused on goods trade and investments in finance or property, which are less affected by the negative aspects of Brexit but could gain significantly from a trade and/or investment deal between the UK and China.

One of the likely effects of Brexit is to make the UK more reliant upon China, as the UK would be with other non-EU countries. The UK's historically very open economy would readjust to non-EU countries if there were greater trade friction between the UK and the EU. In addition, as argued in the thesis, the UK would have reduced bargaining power by itself compared to within the EU because of the sheer size difference. This greater reliance will likely mean that the UK accommodates China on political issues. Human Rights Watch China Director Sophie Richardson said that she feared that Brexit would make the UK less able to stand-up to China on human rights (Interview with Sophie Richardson 2017). Other issues that could tilt in China's favour include MES and the arms embargo (Godement and Stanzel 2016). Thus on

Brexit, despite all the political turbulence, the likely long-term political forecast remains the same in 2020 as it did in late 2016.

### **9.3 Hong Kong**

Despite the formal handover in 1997, Hong Kong has continued to be an underlying issue in UK-China relations. In some ways this is unsurprising, given the historical and cultural ties that Hong Kong shares with both the UK and China. What is perhaps more surprising however is how Hong Kong has become a greater issue as time has gone on. In the early 2000s, Hong Kong fell in significance as a political issue because of the smoothness of the handover and that the Chinese for the most part kept to what they agreed, as explained in chapter three. From 2014 onwards, Hong Kong grew as an issue because of the perceived Chinese interference in the Hong Kong political system, leading to the democracy protests. In the six years since 2014, these protests have become more disruptive and attracted greater political attention internationally.

In September and October 2014, tens of thousands of protestors marched through Hong Kong carrying umbrellas in response to proposed reforms to the electoral system that were perceived as giving the Chinese government more power over candidate selection (Yuen and Cheng 2015). As discussed in chapter three, the UK government did publicly comment on the protests because of fears that it could lead to China pulling economic deals. In 2014, the protests were generally peaceful and focused on the issue they were protesting about. There was some controversy about the actions of the police, and concern over both the 2017 imprisonment of three Hong Kong activists and the 2015 Causeway Bay Books disappearances (Dapiran 2017). This contributed to a gradual bubbling of anger among some sections of Hong Kong society.

The 2019 protests were much nastier than the previous protests, and were more wide-ranging. Purbrick (2019: 465) says the protests primarily regarded “the issue of amendments to the extradition law but with deeper roots in the discontent of large parts of the population”. As of December 2019, there had been “5,800 arrests,

10,000 rounds of tear gas; at least 17 protest applications rejected by authorities, 1,000 retired police officers pressed back into service” and 25% of Hong Kong people had participated in a recent protest (Richardson 2019). Protest-related clashes led to two deaths, and caused several university campuses to temporarily close (*Guardian* 2019, 14<sup>th</sup> November).

The UK government’s response to the Hong Kong protests became slightly more vocal as the protests grew, but they avoided criticising the Chinese government directly. Foreign Office minister Baroness Goldie told the House of Lords (2019) that “We do not believe that the proposed legislative changes in themselves are a breach of the joint declaration”. In September 2019, Foreign Secretary Dominic Raab said he was “concerned” about the protests, called on the Hong Kong police to be “proportionate” and called for “meaningful political dialogue” (UK Government 2019, 26<sup>th</sup> September). These comments are carefully chosen to avoid offending the Chinese government and reflect the power shift towards China since 1997.

It is curious that governments of other countries have condemned China in stronger terms, despite not being signatories to the Joint Declaration. During a visit to China in September 2019, Angela Merkel said that rights and freedoms in Hong Kong “must be guaranteed” (*Guardian* 2019, 7<sup>th</sup> September). This statement is more direct than anything said by the UK government. The US government went even further when Congress near-universally passed the Hong Kong Human Rights and Democracy Act of 2019, which President Trump signed into law. The act (section three) sought to promote democracy and human rights in Hong Kong, including drawing attention to Chinese violations of Hong Kong human rights and supporting free and fair elections for the Hong Kong Chief Executive. This again is stronger criticism than from the UK government.

It is difficult to see a natural end point to the Hong Kong situation. President Xi Jinping has condemned the protesters and said Beijing would “resolutely safeguard the prosperity and stability” of Hong Kong (BBC News 2020, 1<sup>st</sup> January). The Chinese government have a longstanding ‘One China’ policy, which includes Hong Kong as part of China. Under the Joint Declaration, Hong Kong can become fully part of China in 2047, which is only twenty-seven years away. For many protesters,

there is nervousness at China's political system and the associated loss of individual political rights. Some protesters even flew British Hong Kong flags and Union Jacks to protest the perceived erosion of pre-1997 freedoms (BBC News 2019, 15<sup>th</sup> September). It is not obvious how this can be resolved, given both sides cannot get what they want. For this reason, Hong Kong is likely to remain a political issue – both in itself and in UK-China relations – long into the future.

#### **9.4 US-China Trade War**

In the thesis, it was argued that changes to the global economy had a knock-on effect on UK-China relations. The period since 2015 has been no different. The trade war between the US and China has affected the global economy, and had an indirect impact upon UK-China relations. Many of the US' trade complaints against China are longstanding. Indeed, many such issues have been discussed in depth in this thesis, such as around currency manipulation or theft of intellectual property. Both the US and China have changed their behaviours in the last few years that has contributed to the trade war.

Ferguson and Xu (2018: 8) argue that the current trade war represents a new era in US-China economic relations and was sparked by two events. The first was the Federal Reserve's end to quantitative easing in 2014, which caused capital flows out of emerging markets back into the US. The second was the stock market investments made by the Chinese government in 2015, in response to the capital outflow. The Chinese government adopted more interventionist foreign exchange policies and capital controls in response to the perceived hidden domestic financial risks. These policies affected the US – for example, the renminbi depreciation between 2014 and 2017 increased the US trade deficit. Thus, in several ways the trade war was triggered by policies that were pursued by the Chinese government.

The more visible cause of the trade war was the 2016 election of Donald Trump as US president. Trump has – to put it mildly – an unconventional way of conducting diplomacy, using “classic hard bargaining tactics” (Babbitt 2019: 117). Trump's

tendency to escalate made the trade war worse than it otherwise could have been. Trump initially imposed tariffs on steel, aluminium, washing machines and solar panels in January-March 2018, which disproportionately fell on China (Reuters 2020, 15<sup>th</sup> January). After China raised trade barriers of their own against the US on 2<sup>nd</sup> April 2018, Trump unveiled plans for 25% tariffs against \$50 billion of Chinese imports the very next day. The trade barriers have continued to escalate, alongside negotiations on a trade deal. It seems that Trump is much more confrontational and transactional than how other presidents might have been in a similar situation.

It is unclear that there has been a significant effect on UK-China relations from the US-China trade war. The trade war has likely to have cut global growth, which harms global trade and investment. However, the impact upon Europe is forecast to be small, and some have even hypothesised a net positive for Europe (eg Bolt et al 2019). A more protectionist US has the potential to enhance UK-China economic relations because both countries' economies are less able to rely on the US (Basedow 2019). China may choose to buy European or Asian instead of American if the tariffs become a long-term problem. Similarly, it is possible that a more protectionist US might harm US-UK economic relations, which could provide opportunities for Chinese businesses.

So far though, UK-China relations have hardly been affected by the trade war, particularly when compared to Brexit. There is no evidence of significant economic effects of the trade war on UK growth, and even if there was would be minuscule compared to the economic impact of Brexit. Changes to global trade and investment patterns caused by the trade war affect the UK a lot less than Brexit. For these reasons, despite being interesting and of global significance, the trade war is not of massive practical significance for UK-China economic relations.

### ***9.5 China's Market Economy Status***

Another issue that has developed since 2015 is that of China's MES at the WTO. The Chinese government had believed that it would have been granted MES in 2016, fifteen years after joining the WTO in 2001 (Telep and Lutz 2017). MES would



have a major impact upon UK-China economic relations – and indeed, all of China's foreign economic relations – had it been granted because it would have made it harder for other countries to raise complaints against China, such as around dumping (Puccio 2015). It is now 2020 and China has not been granted MES, principally because the EU and US objected.

The reasons why the EU and the US refused to give China MES were similar, namely that do not consider China to have a market economy and have taken issue with what they see as China's anti-competitive practices. The EU has five criteria that non-market economies must meet for the EU to approve granting MES: a low degree of government influence; an undistorted private sector; effective implementation of company law; an effective legal framework; and a genuine financial sector (Puccio 2015: 12). The EU Commission produced a report in 2008 showing that China did not meet these criteria. In May 2016, the EU Parliament (2016) passed a resolution urging the Commission not to grant MES because China had not met the five tests. In June 2016, the EU Commission (2016: 7) said that MES could only be possible with additional trade defence instruments – a “tactical dodge” that avoided giving in without seeking direct confrontation with China (Jakóbowski and Kaczmariski 2016). The EU position is less vulnerable because the US also opposes giving China MES (CNBC 2017).

The Chinese position is that MES should have been granted automatically in 2016. The Chinese government and Chinese media believe that promises had been made at the time of the 2001 accession and that these promises should be kept (Jakóbowski and Kaczmariski 2016). After the EU and the US objected to MES, the Chinese government launched legal action in the WTO, arguing that China should have MES. The judgement of this case has not been made public, but it was reported in the media in 2019 that China had lost the case badly and was therefore dropping the challenge for the time being (eg Bloomberg 2019, 18<sup>th</sup> April; SCMP 2019, 17<sup>th</sup> June). One suspects that this will not be the last time that China's MES is raised as an issue.

In all of these events, the UK was represented by the EU since the UK only had an independent voice in the WTO since February 2020 after Brexit. The UK had voiced

support for China gaining MES during Cameron's premiership (eg EFD 2013: 2), but has weakened that stance more recently. The 2016 Economic and Financial Dialogue states:

“The UK supports the EU's efforts to bring its anti-dumping practices into compliance with its obligations under the provisions of the WTO, including its obligations of Article 15 of China's WTO Accession Protocol.” (EFD 2016: 7)

This is considerably vaguer than the previous support of MES because article 15 of China's WTO Accession Protocol is dependent on whether market conditions are prevalent. The China-UK Economic and Financial Dialogue policy outcomes documents from 2017 and 2019 are silent on the MES issue (EFD 2017; 2019).

It is curious how unified the West have become on the MES issue, in contrast to the AIIB or the more recent division over how to handle Huawei. At a time when the West is split on the trade war and perceived as heading in a populist direction, it remains united on this issue. There are three reasons for this. First is the alignment of interests: both the US and the EU have vital economic interests at stake in preventing Chinese dumping. Secondly, the ability of both the US and EU to veto China gaining MES means that China have no incentive to use significant political capital to lobby on this, given the low chance of success. Thirdly, as set-out in the introduction, norm changes mean that China is now perceived as being a greater economic threat than before, and this means the West is more likely to stand together on issues that make a real difference. This provides a brief explanation as to why the West has acted how it has.

## **9.6 Investment Screening**

At UK national level, investment screening has become a greater political issue since 2015. In July 2018, the May government launched a consultation on national security and investment, with the Business Secretary Greg Clark saying that inward investment needed “appropriate safeguards to protect our national security and the safety of our citizens” (UK Government 2018, July: 3). China was not directly mentioned as a reason for carrying out this consultation, but it was often interpreted

at the time as the rationale for the review (eg *Financial Times* 2018, 25<sup>th</sup> July; *New York Times* 2018, 24<sup>th</sup> July; Brattberg and Soula 2018). This suggested that Theresa May was more sceptical of Chinese investment than David Cameron and George Osborne were.

The big story relating to Chinese investment in the UK concerns Huawei, the telecoms company. This was already an issue before 2015 (as discussed briefly in chapter seven), but the issue came to a head in January 2020 when the UK government announced the conclusions to its Telecoms Supply Chain Review, which looked at the 5G network. The conclusion was that “high risk vendors” were allowed to participate in the UK’s 5G network, but they could not access sensitive parts and were limited to a minority presence of 35% in the non-sensitive parts (UK Government 2020). Neither China nor Huawei were directly mentioned in the government’s announcement, but it was so clearly directed at Huawei that Prime Minister Boris Johnson had a telephone conversation with President Trump about it (BBC News 2020, 28<sup>th</sup> January). This further demonstrates quite a shift compared to before 2015.

At regional level, EU foreign investment screen regulations entered into force in April 2019 (EU Commission 2019). EU Commission President Jean-Claude Juncker said that the objective of these regulations was to “help Europe defend its strategic interests” (quoted in European Commission 2019). The framework helped EU countries to coordinate on inward FDI, by facilitating information sharing and allowing the Commission to issue opinions on investments that impact more than one member state. Although the UK has now officially left the EU, this framework continues to apply to the UK during the transition period. The UK government said that they did not expect the regulations “to substantially affect the UK’s investment screening regime overall” (UK Parliament 2019). The EU regulations were largely symbolic since national governments still retain the ultimate say over whether foreign investment enters their country.

Although the regulations represent a move towards a centralised EU system, most of the power over inward investment remains with national governments. At the time the EU regulations came into force, half of EU countries had their own national

screening mechanisms in place (European Commission 2019), including Europe's three major powers, France, Germany and the UK. France was one of the first European countries to have investment screening in 2003, but has since strengthened it (Brattberg and Soula 2018). In 2017, the Macron government nationalised STX France to ensure a military shipyard did not get acquired by an Italian company who had partnered with China (*Financial Times* 2017, 27<sup>th</sup> July). The German government has taken on greater powers to block foreign investment, and have blocked Chinese investment in Leifeld Metal Spinning and a Chinese takeover bid for 50Hertz, companies that work in metals and electricity respectively (Brattberg and Soula 2018). These actions from the French and German governments are more forceful than that of the EU Commission. This reinforces the arguments made in the thesis about the importance of nation states in EU-China investment relations. It also demonstrates that the EU has less control over investment than with trade.

## **9.7 Conclusion**

Naturally, many of the themes of UK-China relations 1997-2015 have continued into 2015-2020. The most significant difference between the time periods is Brexit, which has the potential to change UK-China relations because it takes out a level from the four-level game. That means that non-UK EU interests do not need to be taken into account and China has greater negotiating power over the UK. Unlike the 1997-2015 period, where changes to the China game were the most important determinant in changing the bilateral relationship, it seems to have switched to the UK.

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